or interchange operations as I have referred to them and of course to the general public.

Q. Wasn't the tax reason the real reason for naming Safe Harbor in Exhibits 71, 73 and 76?

* * *

[3328] The Witness: I have no reason to believe it was the "real reason" or the principal reason. I know that it was one material reason.

* * *

[3330] Q. When Safe Harbor secured the right to sell electric energy to others than Consolidated and Holtwood in that proceeding you described before the Pennsylvania Commission in 1932, that merely removed a barrier to naming Safe Harbor to Exhibits 71, 73, 76 and Exhibit 10. Isn't that so? A. It did remove a barrier.

Q. All right. A. I don't want to qualify it.

Q. That wasn't the reason why it was named in those agreements? A. Then I don't understand what you mean.

Q. You stated that one of the reasons for naming Safe Harbor was to save taxes—right? A. That is correct.

Q. Having in mind that that was a reason for naming Safe Harbor, was the removal of a legal restriction a reason for naming Safe Harbor in its contracts? [3331] A. Not if I understand your question, but I don't think I said that here.

Q. Look at page 239. "There were also two other reasons. One was a legal reason having to do with the right of Safe Harbor to sell".

That wasn't a reason for naming them, was it? A. I think I understand your point now, and again I am getting into legal grounds. I will have to apologize for my lack of legal knowledge because it is strictly legal, but my understanding is that Safe Harbor was named a party to Exhibit 71, that is one of the reasons and there were several, to assure—and that is not the right word to use but I hope it will be understood—that Safe Harbor might establish

the legal right to sell either directly o: with others in York County in the future.

Now, Mr. Examiner, that is the best explanation I can give.

Q. In other words, there was a barrier to naming Safe Harbor? A. Pardon?

Q. There was a barrier to naming Safe Harbor in the agreements? A. In all of the agreements; yes, sir.

Q. And that barrier was removed in 1932 by reason of the proceedings before the Pennsylvania Commission that you [3332] mentioned—right? A. That is right.

Q. Then after that barrier was removed it was possible to name Safe Harbor in the agreements—right? A. In any and almost all agreements as far as I know.

Q. Now, why was it desirable to remove the barrier? A. In order that Safe Harbor could undertake certain specific and joint operating responsibilities in connection with Exhibit 10 and other contracts of Penn Water.

Q. It was to save taxes? A. Among other reasons, yes.

Q. Wasn't that the only reason?

* * *

[3333] The Witness: What's the only reason? I thought we were talking about reasons all afternoon.

[3334] By Mr. Goldberg:

Q. Savings of taxes. A. I gave three reasons on page 239.

Q. I know what you gave.

Wasn't the tax reason the only reason for seeking to eliminate the barrier and naming Safe Harbor? A. No, sir. I had stated very recently that one of the reasons, if not the initial impelling reason—and I underscore initial,—that Safe Harbor's rights were extended, or that a request was made to extend them, was in order that Safe Harbor could undertake its responsibilities under the railroad contract identified as Exhibit 10.

Q. But that reason didn't have anything to do with naming them in Exhibits 71, 73 and 76—right? A. That is right.

Q. Was tax savings the only reason for naming them in Exhibits 71, 73 and 76? A. I don't understand so.

Q. Did the tax reason have anything to do with assurance of supply? A. I don't think so.

* * *

[3385] Q. When I asked you this question, which I am about to repeat, you said you could not answer it unless you left Pennsylvania Railroad out of consideration.

Leaving them out of consideration I would like to have you answer the question:

When stream flow gets down that low—and by "that low" I mean around 2500 C. F. S.—is it your statement that any deficiencies which may exist, exist only because of a method of operations that is intended to achieve maximum overall economy and maximum overall utilization of resources? A. I think that is right.

Q. In other words, there are never any deficiencies that exist solely because of the lowness, if I may put it that way, of stream flow? A. Of course, I have to take into consideration in my answer, and I did take into consideration, the fact that there is storage in the Holtwood and Safe Harbor ponds sufficient to carry all of the firm power obligations of Penn Water and Safe Harbor to Metropolitan Edison, Pennsylvania Power and Light and to Coatesville for over a week and perhaps several weeks depending just on what the variations in flow may be. You realize, of course, we seldom have flows in the vicinity of 2500 C. F. S. for any length of time. We can, of course, call on pondage or water storage for such very low periods, but [3386] normally we do not use the pondage in that manner, that is, solely for the firm power consumers, but rather use it for the overall maximum economy considering the other contracts of Penn Water and Safe Harbor and the use of natural resources.

Q. Have you in your last answer considered what is available to Penn Water under the interchange agreements as backfeed from Consolidated or have you intended to eliminate that from your answer? A. I did eliminate it in my answer.

Q. You intended not to give that any consideration? A. I thought that was your question.

Q. In saying that there is never a time when a deficiency in supply is the result of low flows?

* * *

The Witness: And by "deficiency" as you are using it, you mean those occasions when Penn Water and Safe Harbor either obtain supplemental energy and other services from others or use their pondage for the short periods. Of course, the latter method is not the one normally used. Rather we do supplement the services in order that we may obtain maximum overall economy and maximum utilization of natural resources.

* * *

[3387] Q. In other words, at all times Penn Water and Safe Harbor, as you look upon the situation are self-sufficient when it comes to meeting the requirements of the Pennsylvania customers. By "self-sufficient", I mean they don't need the interchange and they don't need the backfeed. A. No, I don't mean that at all. We don't ordinarily look at operations in that manner.

You have asked me to look at it in that manner and I have given you an answer accordingly. Actually, of course, we do operate the system giving consideration to all of the contracts and the operating responsibilities under each and every one of them. And it is for that reason that we do procure, and by "We" I am speaking of Penn Water and Safe Harbor, backfeed energy from Baltimore in part and interchange from the northern companies in part in order that the maximum utilization of natural resources and the maximum economy can be obtained in consideration of the

expressed intent to do so under E, F, and G and H and I.

Q. As I understand your answer, you are saying from a practical standpoint, from a practical operating standpoint, there is available these supplies from Metropolitan Edison, Philadelphia Electric, and Pennsylvania Power and Light and Consolidated which enables Penn Water to meet the [3388] requirements of the Pennsylvania customers. Is that right? A. That is right.

Q. But looking at it from the standpoint of the provisions of the contract, is it your statement that Penn Water is at all times self-sufficient? A. May we add Safe Harbor to Penn Water?

Q. All right. A. Under normal operations Penn Water and Safe Harbor do require supplemental services in order that they may operate to obtain maximum overall economy and fullest utilization of natural resources.

Q. And from a practical viewpoint you say they have always been able to get supplemental supply? A. That is correct, there always has been ample supplemental services available to it.

Q. And they have been able to get it without a firm obligation on the part of any of the suppliers to Penn Water or Safe Harbor or both—right?

* * *

THE WITNESS: What do you mean by "firm obligations"?

By MR. GOLDBERG:

Q. Intended to be available at all times. A. That is correct, there is no firm obligation on the part of any customer to Penn Water and Safe Harbor.

[3389] Q. On the part of the supplier to Penn Water and Safe Harbor. You said "customer", didn't you? A. On the part of the suppliers of such supplemental energy.

* * *

[3392] Q. Has there ever been a time during the existence of Exhibit 72 that you were of the opinion that Safe Harbor

was rendering electric services under Exhibit 72? A. To whom?

Q. Either Penn Water or Metropolitan Edison? A. It certainly is true that Safe Harbor in my opinion has not and is not rendering electric services to Metropolitan Edison Company under Exhibit 72, but Safe Harbor does have an operating responsibility to Penn Water in connection with the latter's operating responsibility to Metropolitan Edison under Exhibit 72.

Q. And Safe Harbor's operating responsibility to Penn Water in connection with Exhibit 72 originates under Items E, F, and G, does it not? A. I think it does.

Q. Has there ever been a time during the existence of Exhibit 72 that you were of the opinion that Safe Harbor [3393] was supplying electric services under that agreement? A. Yes, it has continually since the contract has been in force and effect, that is since January 1, 1946.

Q. In other words, since January 1, 1946, Penn Water has continuously used electric energy generated by Safe Harbor to meet its obligations to Metropolitan Edison under Exhibit 72? A. And by "electric energy", I am referring to electric services of which energy is one of the attributes.

Q. Has there ever been a time during the existence of Exhibit 72 that you were of the opinion that Safe Harbor had operating responsibilities under that contract? A. Isn't that the same question you just asked me?

Q. No, no. I was talking about supplying electric services and rendering electric services before that. Now we are talking about operating responsibilities, which is another one of your phrases. A. Safe Harbor has not an operating responsibility to Metropolitan Edison under Exhibit 72, but it has an operating responsibility to Penn Water in connection with the latter's operating responsibility to Metropolitan Edison under Exhibit 72.

• • •

[3410] Q. In Article IX of Exhibit 72 this statement appears: "Holtwood represents that for the purposes of this article it is in a position to include the energy and/or capacity of Safe Harbor and for such purposes the same shall be treated as though it were owned and controlled by Holtwood."

How was Holtwood able to state that it is in a position to include the energy and/or capacity of Safe Harbor in connection with Article IX and to further state that the energy and/or capacity of Safe Harbor shall be treated as though it were owned and controlled by Holtwood?

* * *

THE WITNESS: I don't know.

* * *

[3411] Q. What does it mean when Holtwood states that it is in a position to include the energy and/or capacity of Safe [3412] Harbor for the purposes of Article IX and that for such purposes the same shall be treated as though it were owned and controlled by Holtwood?

* * *

THE WITNESS: To me as an operating man my understanding is that Penn Water was in a position to arrange for the interchange sales of certain energy and capacity from the Safe Harbor plant as though Holtwood and Safe Harbor were rendering those services jointly so far as Article IX is concerned.

* * *

Q. How did it get into that position? What are the facts and circumstances that enable it to make such an arrangement?

* * *

THE WITNESS: First, Penn Water and Safe Harbor operate [3413] their respective hydro plants for a maximum overall economy and for maximum utilization of natural resources. They have been doing that for some time.

Secondly, this contract was entered into by Penn Water with the knowledge and consent of Baltimore Company who was the other party with Penn Water that had whatever entitlements were due them from Safe Harbor Company.

By Mr. Goldberg:

Q. Under Items E, F and G? A. I think so, after taking into consideration the other contracts.

Q. Have you completed your answer? A. Yes.

Q. This reason that you gave, that Penn Water and Safe Harbor operate their respective hydro plants for maximum overall economy and maximum utilization of natural resources, and have been doing it for some time, that applies throughout the period 1932 to date—right? A. That is correct.

Q. And the reason you gave that Exhibit 72 was entered into by Penn Water with the knowledge and consent of Baltimore Company, who was the other party with Penn Water who had entitlements under E, F, and G, that applies to all contracts which Penn Water ever has entered into since Items [3414] H and I were entered into—right? A. I think that is correct.

Q. And that has been the case since 1931, then, the date of Item "H"? A. The early part or middle of 1931—that is correct.

Q. So that the reasons that you gave as enabling Penn Water to assure the availability of the energy and/or capacity of Safe Harbor in connection with the interchange arrangements under Exhibit 72, are reasons that have existed since 1931 and were available to Penn Water throughout the period 1931 to 1946. Right?

* * *

The Witness: I think so.

By Mr. Goldberg:

Q. In other words, without naming Safe Harbor in Exhibit 72, Penn Water was able to make an assurance to

Metropolitan Edison with respect to the energy and/or capacity of Safe Harbor. Right? A. For interchange purposes only, and that means with a limited responsibility on a time to time basis.

• • •

[3427] Q. Now, if they can do it with respect to interchange why can't they do it with respect to firm power obligations? A. I don't know. Perhaps they can.

Q. And they probably can do it without even asking Safe Harbor, can't they? A. I don't know.

Q. They did it with respect to interchange, didn't they? A. Apparently so.

Q. You know that is so, don't you? A. Subject to the discussion we have just had, yes.

Q. You know that is so because you were intimately associated with those negotiations. A. I have endeavored to recite what happened.

Q. As a matter of fact, there is reliance upon Safe Harbor's capacity and energy for the purpose of meeting the firm power requirements in Exhibit 72, isn't there? A. Very definitely.

Q. And there is that reliance again without Safe [3428] Harbor's inclusion in Exhibit 72, isn't there? A. Safe Harbor is not a named party, nor does it have any operating responsibilities directly to Metropolitan Edison under Exhibit 72.

Q. But there is an assurance of supply to Metropolitan Edison under Exhibit 72 which involves the capacity and energy of Safe Harbor? A. I think that is right.

• • •

[3433] Q. Had there been a change in the tax laws in Pennsylvania between the time Exhibit 71 was entered into and Exhibit 72 was consummated? A. I think so, but I am not too familiar with the tax laws.

Q. And it was because of that change in tax laws that you said "The third reason no longer appeared to exist." Is that right? A. I think that was part of it.

Q. Was there any other part of it? A. Not except that I understood that the tax situation, whatever it was then, or is now, and it has not been changed since this contract was entered into or negotiated, did not appear to be important.

* * *

[3436] Q. When electric energy is not sold to Consolidated under Items H and I, what electric services does it receive? A. It may receive a lot of electric service without there being any energy present—capacity services, power factor cooperation or reactive, voltage, current, frequency.

Q. Are you finished, Mr. Spaulding? A. I think so.

Q. When you mentioned voltage and current did you have in mind wattless energy? A. I did.

Q. Wattless power, I should say. A. I think that is right. Of course, there could be the capacity service where there was no current or reactive [3437] present, merely a readiness to serve.

Q. In connection with Article 6 of Item "H" does Consolidated provide any such services such as a readiness to serve? A. At times there may be on an interchange basis when there have been arrangements made for the interchange of capacity without any energy and Baltimore may make that service available on its own system without any change in the current energy or power flowing.

Q. When no energy is flowing to Consolidated you stated that such services as capacity, power factor cooperation, reactive, voltage, current and frequency were being furnished Consolidated by Penn Water? A. There can be, and may be.

* * *

[3443] Q. You say revenues received by Penn Water are used to reduce Consolidated's payment under Items H and I to Penn Water—right?

* * *

THE WITNESS: May we be a little more specific? The revenues which are actually collected by Penn Water from the firm power customers of Pennsylvania, in part for services rendered alone by Penn Water and in part for services rendered jointly by Penn Water and Safe Harbor, may reduce the payments made by Baltimore to Penn Water under H and I in the sense that the formula for computing the revenues receivable by Penn Water under H and I take such revenues from Pennsylvania customers into consideration.

* * *

[3445] Q. Now, then, do you say that Safe Harbor receives revenues from the supply of power and energy to persons or corporations other than Consolidated and Holtwood that should be credited by Safe Harbor in computing the power bill to Consolidated and Holtwood? A. I don't know. It is not so accounted for today, and has not been for the duration of the contract.

Q. If there were such revenues there is the provision under which the credits could be made in the power bill computations—right? A. I think so.

Q. But there are no such credits being made today—right? A. Not currently, no.

* * *

[3454] MR. SPARKS: That is correct.

Mr. Examiner, upon review of the record we find there is one matter which Mr. Goldberg requested of Mr. Spaulding, which has not yet been reported upon. Mr. Spaulding is ready at this time to report on it, and it involves a reference to the Pennsylvania proceedings in 1932.

MR. GOLDBERG: If you will identify that proceeding, Mr. Spaulding, I would appreciate it.

THE WITNESS: At transcript page 3334, you asked me to identify the proceeding before the Public Service Com-

mission of the Commonwealth of Pennsylvania relating to the modification of that Commission's order, fixing the companies to which Safe Harbor Company was allowed to sell directly or indirectly.

The petition to the Commission for permission to sell its service to others than originally determined was dated March 29, 1932.

The report and order of the Commission is dated January 10, 1933, in re "Application of Safe Harbor Water Power Corporation for modification of the certificate of public convenience approving the beginning of the exercise of the rights, power or privilege of the supply, storage or transportation of water and water power for commercial and manufacturing purposes in Manor township, Lancaster County, and Chanceford township, York County, by amending the [3455] restriction which limits service to certain customers named therein."

The application docket shown on that order is No. 21579 (folder No. 2).

• • •

[3479] Q. What do you mean when you say that the electric services from Consolidated are co-mingled with the electric services at Safe Harbor or at Holtwood? A. I mean that those electric services such as kilowatt-hours, kilowatts and reactive, which involves current and voltage, of course, when those are mixed with similar services, or other electric services of the Safe Harbor Company or of another company or another source, there is a co-mingling of those electric service attributes.

Q. Are you using "mixed" and "co-mingling" synonymously? A. I think so, except that I am using it in an electrical sense.

Q. You are using it in an electrical sense? A. Yes, and I have no high, scientific implications in that use, either, Mr. Goldberg.

Q. You can be sure I haven't either, because I don't know what they are.

I am interested in finding out how these electric services from Consolidated mix with electric services from other sources of supply. A. Well, I don't want to be too technical. Perhaps you will forgive me if I used an expression that the Examiner used [3480] not long ago. There is a vector relation between them which results in a new vector, and that is the type of co-mingling I am talking about.

Trial Examiner: I used it correctly, didn't I? It was about three weeks ago.

The Witness: Yes, you used it very properly, Mr. Examiner. It is a simple way of expressing what is being described on the stand.

* * *

[3502] By Mr. Goldberg:

Q. From the time Safe Harbor began operating in 1932, ~~it is the fact,~~ is it not, that Penn Water in connection with its commitments under Exhibits numbered 136, 137, 138, and 139 relied at times upon the supply from Safe Harbor, right?

The Witness: May I have that question again, please?

(Question read.)

The Witness: No, that is not strictly correct. Safe Harbor electric services could not be used by Penn Water in respect to the contract identified as 139 until after the Pennsylvania Commission had authorized Safe Harbor to permit [3503] its energy so to be used.

By Mr. Goldberg:

Q. Let me see if I understand you? A. I think that as respects the other three contracts, namely, 136, 137, 138, that Safe Harbor's electric services were available to Penn Water for the latter's use in rendering services to the named companies in those three contracts, customer companies in those three contracts.

Q. I don't understand why Safe Harbor's electric services were not available for use to Penn Water in connection with Exhibit 139. A. Because until the Pennsylvania Commission authorized such use by Penn Water, Penn Water could not use Safe Harbor's services in connection with Exhibit 139. So there was a period from the execution of 139 up until the final order of the Pennsylvania Commission permitting such use that Safe Harbor's services could not be used by Penn Water in connection with that contract.

Q. Let's see. The electric services would be available to Penn Water under Items E, F, and G—right?

The Witness: May I have that question?

(Question read.)

The Witness: I assume so.

By Mr. Goldberg:

Q. Having been made available to Penn Water under Items [3504] E, F, and G, what restriction was there on Penn Water which would have prevented it from using the electric services and supplying Metropolitan Edison under Exhibit 139? A. It was a restriction which went with the certificate of public convenience and necessity issued by the Public Service Commission of Pennsylvania to Safe Harbor Water Power Corporation which limited such use.

Q. Wasn't that restriction that Safe Harbor could only sell to Consolidated and Penn Water? A. No, it went further than that. It provided that Penn Water could only use such services for resale to its then named customers, and as I recall those named customers they were Chester Valley Electric, Edison Light and Power Company of York and Pennsylvania Power and Light Company. It did not include Metropolitan Edison.

Q. So there was a restriction upon Penn Water's use of the electric energy received under Items E, F, and G from Safe Harbor. Is that it? A. That is correct.

Q. When Penn Water was undertaking to supply Metropolitan Edison during that period of restriction did

it have to make some sort of an identification of the electric energy it received from Safe Harbor and somehow or other keep it from getting into Metropolitan Edison's system? A. It had to establish an electrical barrier to prevent that flow.

[3505] Q. Did it? A. It did.

* * *

[3520] Q. Mr. Spaulding, why did you limit your determination in Exhibit 35 to firm power services?

* * *

The Witness: I did not limit it to firm power services. I made adjustments for interchange services as well.

By Mr. Goldberg:

Q. The title of your exhibit is "Costs of Penn Water's and Safe Harbor's firm power services rendered to Baltimore Company, 1945 and 1946." Shall we change that title? A. No, but in that study, and in connection with my testimony relating thereto, the operating savings resulting from all interchange transactions become a credit or are passed on to Baltimore Company, and therefore in determining costs of services of Penn Water and Safe Harbor to Baltimore Company, proper adjustments were made in order that all of those benefits from operating savings resulting from [3521] interchange were credited to Baltimore Company in accordance with the provisions of the actual operations and the contracts relating thereto.

Q. In firm power services you included backfeed from Baltimore and interchange services to the Pennsylvania customers. Is that right? A. That is right.

Q. And backfeed and interchange sales do not involve a continuing operating obligation. Isn't that so?

* * *

The Witness: That is right.

By Mr. Goldberg:

Q. Well, then, in what way are they firm power services? A. The resultant effects, or the resultant services

of Penn Water and Safe Harbor are firm power services, and the operating economies resulting from interchange become a credit, in effect at least, to the Baltimore Company, and they were so treated.

Q. Even though they may become a credit to the Baltimore Company, you may not treat them as firm power services. Isn't that so? A. And I didn't treat them as firm power services.

Q. Even though you included them in your study of the [3522] costs of firm power services rendered to Baltimore Company. Is that right? A. The interchange operations involving the purchase or procurement of interchange services from Baltimore Company on the one hand and from the Pennsylvania customers on the other are in part used by Penn Water and Safe Harbor in connection with the rendering of firm power services, but the operating savings from the interchange transactions between Baltimore Company and Penn Water on the one hand and between Penn Water and Safe Harbor and another company on the other hand were credited to Baltimore Company in Exhibit 35.

* * *

Q. You say that the supply from Consolidated was used by Penn Water and Safe Harbor in connection with rendering firm power services. Did I understand you correctly? A. Frequently, yes.

Q. You mean firm power services to Metropolitan Edison and Pennsylvania Power and Light Company, Philadelphia Electric Company? A. Yes, among others, and that is the energy that we have been talking about the last few days as the supplemental [3523] energy that Penn Water and Safe Harbor use in connection with their firm power obligations.

Q. Do they use it in connection with their obligations under Exhibit 10? A. It may be.

Q. Do you know whether they do? A. I can't earmark the kilowatt hours.

Q. You mean you don't know? A. I cannot paint the kilowatt hours. I have accounted for them that way.

Q. You mean you have accounted for them on the theory that they are so used? A. That is right, together with other services.

Q. In determining the costs of Penn Water's and Safe Harbor's firm power services rendered to Baltimore Company—and please understand I am using your title, not accepting that as the fact—have you included the costs of all these attributes of electric services that you have been discussing throughout your cross-examination?

* * *

The Witness: I think so.

* * *

[3524] Q. In the third paragraph of that general statement on Page 2 of Exhibit 35 you stated that schedules 3, 4 and 5 of Exhibit 35 provide the basis for the determination of the capacity and energy service components of Penn Water's and Safe Harbor's combined firm power services to Baltimore Company. Is that right? A. It so states.

Q. Did you by that statement intend to cover all of the attributes of electric services you have been discussing? A. I did.

Q. So that in the phrase "capacity and energy" you covered voltage, power, phase, capacity, power factor, current, frequency, and every other attribute you have ever mentioned in this proceeding as an attribute of electric service. Isn't that so? A. I don't think there are any other attributes, but I [3525] did so include them.

Q. You thought it appropriate to include them that way, did you?

* * *

The Witness: I presume so, because my allocations were limited to the allocations of capacity and allocations of energy. I had no basis for making an allocation of the other attributes of electric service because no records of sufficient completeness are available for the purpose.

I did give careful consideration to them and concluded that by the allocation that was used for capacity and energy that I had properly included the allocation of all of the other attributes of electric service.

* * *

The Witness: And I would like to add that I did [3526] recognize that I was making a very conservative assumption with respect to the services rendered to Baltimore Company, because, in my opinion, and based on the meager records that are available, Baltimore is provided with a very much higher percentage of power factor cooperation than any of the other customers of Penn Water and Safe Harbor.

By Mr. Goldberg:

Q. Do I understand by your last statement that you have been very liberal to Consolidated—— A. I think I was liberal to Consolidated in that respect, that is correct; generous, may I say.

Q. That is what I meant. Now, then, you say you don't keep adequate records to enable you to make an allocation of the costs of voltage, of power, of phase, of power factor cooperation, of current and of frequency. Is that right? A. I didn't say that. I said I did not have sufficiently accurate records to make an allocation of the cost of power factor cooperation between the customers.

Q. Why doesn't the company keep adequate records for that? A. Because it has not heretofore used them in connection with the computation of the bills rendered, and this is the first time that it has had to make a cost allocation of this nature.

Q. Is it your statement that costs are incurred by Penn [3527] Water and Safe Harbor in connection with the furnishing of voltage, power, phase, power factor, current and frequency? A. Let's take them one at a time if we may.

Q. All right. Voltage. A. Costs are incurred in maintaining constant voltage, yes.

Q. Power. A. That is part of the other services rendered, including energy and capacity.

Q. In other words, the costs of power are in the capacity and energy. A. I think so.

Q. Why do you call it a separate attribute? A. I don't know that I would call it a separate attribute. It is treated separately under certain circumstances and referred to in some instances as power and in some instances as capacity and energy, and I have used it because it has been so used.

Q. And even in your technical distinctions which you have been making it is all right to do that, isn't it? A. I think so.

Q. Any costs incurred in connection with phase? A. Yes, it costs considerably more to provide single phase power than three-phase power.

Q. Are those costs in the capacity and energy? [3528] A. No, usually related to the special facilities installed.

Q. How about power factor cooperation? Any costs incurred? A. Very definitely.

Q. How about current? A. I think that that is one of the attributes that is allocated in connection with capacity and energy.

Q. And it is all right to say that current is not really a separate attribute, isn't it? A. No, I don't think I would say that. I would say that I could not determine the separate costs for current by itself.

Q. How about frequency? Any costs incurred? A. Costs are incurred in order to maintain frequency tolerance desirable, and frequently very high costs are incurred.

Q. Have you left out of your Exhibit 35 the costs incurred in rendering firm power services to Baltimore for voltage, phase, power factor and frequency? A. I have by the method used assumed that with an allocation of special facilities on the one hand, of capacity on the other hand, and of energy on the third hand, that the other at-

tributes of electric service were in the resultant proportion. I did not attempt to make a separate allocation [3529] of costs for power factor cooperation, a separate determination of the costs incurred for frequency, that is for the maintenance of frequency within close tolerances, nor for the costs incurred in maintaining voltage within close tolerances.

There are costs incurred, but in my opinion they could not readily be segregated separately.

Q. And you think you have gotten them in, anyway, as part of capacity and energy. Is that it? A. I think I have gotten them in in connection with all of the costs I have used and that I have allocated them to Baltimore on a very conservative basis.

Q. Well, if you do not have the records which enable you to determine what the costs are in connection with the rendering of voltage services, could you fix a rate for the voltage services rendered to Consolidated? A. If it appeared to be of sufficient importance a special charge could be made for maintaining that service, yes.

Q. Do you think it is of sufficient importance? A. It has not been so considered to date.

Q. Do you consider it now of sufficient importance? A. I do not think it is of sufficient importance to segregate from the other costs, no.

Q. From the capacity and energy; right? A. I think that those costs are properly allocated to Baltimore as I have done.

[3530] Q. In other words, you think it will be all right just to fix a rate for capacity and energy. Is that right? A. I didn't say that at all, Mr. Goldberg.

Q. You think you will have to fix a rate for voltage? A. No, I don't think so.

* * *

[3531] Q. Up to the present time the company has never kept adequate records so that you could determine the costs of rendering voltage, phase, power factor and frequency by

[3532] Penn Water and Safe Harbor to Baltimore Company—right? A. As separate components I think that is correct. I emphasize "separate components", as distinct from electric services as such.

Q. Do you know why they have not kept records to enable them to make that segregation? A. Because it has not been necessary to segregate them in connection with the determination of the charges to be made under the contracts.

Q. And it is not necessary today, is it? A. Not in a determination of the charges to be rendered under the contracts.

Q. The determination of the charges to be rendered under the contracts are based upon investments of Penn Water and Safe Harbor, all of their operating expenses and all of their costs, with the exception of those investments and those costs you and I discussed the other day wherein you indicated that certain investments and certain costs are not included by reason of negotiations between Consolidated and Penn Water. Isn't that so?

* * *

The Witness: That is my understanding, and such payments or charges are independent of the actual services rendered or the proportion of the attributes that may or may not be [3533] present in those electric services.

* * *

[3544] Q. So that with respect to the question of costs incurred by Penn Water alone for service rendered to Consolidated, or for service to any of Penn Water's customers, it follows, does it not, that Exhibit 35 does not supply the data required to make a proper allocation of excess revenues among the various customers served, and in my use "excess revenues" I want you to assume that may be the result.

* * *

The Witness: Of course, I don't agree with that assumption.

* * *

[3545] The Witness: I will have to qualify the answer, Mr. Examiner. It does in my opinion supply all the data necessary to compare the revenues with the costs incurred in connection with the firm power services rendered by Penn Water and Safe Harbor to Baltimore.

* * *

Q. How about Penn Water alone? A. No, it does not do that and it cannot do that.

* * *

[3598] Q. Under what operating conditions are those capacity services we are talking about furnished to Consolidated?

Mr. Sparks: May we have the question, please?

(Question read.)

The Witness: Perhaps we can refer to Exhibit 8.

[3599] By Mr. Goldberg:

Q. All right. A. The capacity available to the system, and therefore in part available to Baltimore Company, in high-flow as shown by the lower left-hand chart is available 24 hours during the day. During what I may term "intermediate flows" or a flow approaching average flow, that is shown in the lower middle chart, the hydro capacity may in part be operated as spinning reserve or may in part be available to Baltimore Company, and in low flow generally shown by the lower right-hand chart a large part of the hydro capacity operated is being operated as spinning reserve. It can not be shown, of course, from those charts on Exhibit 8 how much of that capacity is being furnished to Baltimore, but it does show the nature of the operations, and various manners of operations.

Q. You say you can not determine how much of the capacity is being furnished to Baltimore from Exhibit 8?

A. No, sir, but you asked me under what operating conditions. I endeavored to explain it from reference to Exhibit 8.

Q. Yes, I appreciate that. Have you determined how much is being furnished, how much capacity is being furnished, to Baltimore under the three operating conditions you show on Exhibit 8? A. Well, of course, the three typical or different conditions that are shown when you look at them from the [3600] yearly operation tend to merge one into the other. There is no sharp distinction except, perhaps, for high-flow between something just below high-flow and there is a gradual change down to the lower flows. It requires consideration of the operating records of the companies in order to determine what the capacity services were and how frequently they were rendered.

Q. Have you determined that? A. I have analyzed those operating records, as I have said several times. My answer was not a mathematical answer. I did not add up any figures and arrive at a conclusion by dividing by so many hours.

Q. But as a result of your analysis you reached the one conclusion, 50 per cent? A. No, indeed. I reached the conclusion that the capacity services to Baltimore were considerably more than 50 per cent of the time. I should say that capacity service is being rendered more than 50 per cent of the time. It may be in varying amounts and in varying times during any day.

I also considered the time or the hours or the amounts of energy that are being delivered to Baltimore Company and where reactive records were available, the amount of such services rendered, but they are of a more limited nature. From an analysis of those records I concluded that a 50-50 allocation was a reasonable one to use.

[3601] Q. Did you conclude it was the only reasonable one? A. No. I have stated that ratio might vary one way or the other. I cannot state how much it would vary. It was for that reason I made some check figures to see

whether the resulting answer would have been materially different had I used some figure other than 50 per cent, and when I found that a reasonable range in the vicinity of 50-50 did not materially change the answer I was satisfied to use the exact figure of 50-50.

Q. Did you feel that the 50-50 basis was appropriate for the Pennsylvania customers as a group? A. I did not consider the Pennsylvania customers alone as a group. As I explained yesterday, I gave consideration to the use and usefulness of these services to each, as well as to groups of these customers, and it was because the use and usefulness of the services did vary materially both in amounts and in the variation of those amounts during the year that I concluded that a 50-50 allocation was reasonable.

* * *

[3618] TRIAL EXAMINER: Very well.

Counsel for the Pennsylvania Public Service Commission.

By MR. MILLER:

Q. Mr. Spaulding, will you define the term "backfeed" for the record? A. I think I have used the term "backfeed" in only one instance, and that relating to the electric services supplied by Baltimore Company under Article 6 of the 1927 agreement.

On occasions, and I may in this record have so used it, we have referred to "backfeed" from our Pennsylvania customers over the inter-connected transmission lines we have with them in connection with interchange transactions. I think both uses are correct because backfeed takes place when these interchange services are flowing in the opposite direction from that in which the electric services are flowing for which those facilities were provided.

Q. Using backfeed in the sense that you have stated, [3619] is it always possible for Safe Harbor Water Power Corporation and Pennsylvania Water and Power Company to meet the total of their firm power obligations to Penn-

sylvania Power and Light Company, Metropolitan Edison Company, Philadelphia Electric Company and the Pennsylvania Railroad Company in Pennsylvania without any backfeed from Baltimore Company if the Safe Harbor and Holtwood ponds are operated and controlled in a manner which will best utilize the natural resources of the Susquehanna River, and will also represent or be the most economical operation of the Safe Harbor and Holtwood hydro facilities, and if the Holtwood Steam Plant is used for the purpose of supplying firm power to Pennsylvania customers in Pennsylvania?

Would you like to have that question read? A. I would like the first part of it read. I think I understand the last part.

(Question read.)

The Witness: Yes, so long as Penn Water and Safe Harbor are in a position during those unusual occasions of very "low flow" to arrange for the supplemental energy from their Pennsylvania customers under the existing interchange arrangements.

* * *

Q. Are they now in such a position? A. They are.

[3620] Q. Do Penn Water and Safe Harbor have such arrangements? A. Yes, sir, in connection with the interchange provisions of contract identified as Exhibit 72 with the Metropolitan Edison Company, the contracts identified as Exhibits 76 and 77 with the Pennsylvania Power and Light Company, and the contract identified as Exhibit No. 134 with the Philadelphia Electric Company.

[3621] Q. Are the Pennsylvania firm power obligations always met without any backfeed from the Baltimore Company? A. No.

Q. Why not? A. The procurement of supplemental energy under its interchange arrangements, including Article 6 of the 1927 contract identified as Item "H", are arranged in order to obtain maximum overall economy con-

sistent with maximum utilization of natural resources and in recent years, that is the last few years, it has been more economical to procure such energy from the Baltimore Company largely because they had available generating facilities with a lower operating cost than was available at the time on the systems of these companies to the north with whom we have interconnections.

Q. Then is it accurate to say that under the existing physical and contractual situation the obligations of Safe Harbor and Penn Water to the Pennsylvania customers, including the Pennsylvania Railroad Company in Pennsylvania can be completely fulfilled without any backfeed from Baltimore Company but that by reason of economic factors some backfeed from Baltimore is used in fulfilling the obligations?

THE WITNESS: May I have the question again, please?

(Question read.)

THE WITNESS: Yes, I would say so. There are physical connections by which those services can be procured from [3622] northern companies under the interchange contracts I have just referred to, and the contract provisions provide for procuring them from the point where it is most economical, and that is the reason that a large, or a considerable, portion of the supplemental energy required by Penn Water and Safe Harbor has been obtained from Baltimore Company under Article 6 of the contract identified as Item "H".

* * *

[3640] MR. STURTEVANT: Now, Mr. Spaulding, do you have an opinion as to whether the additional capacity of No. 3 Unit at Riverside would be needed in the system if the Pennsylvania Power and Light contract was terminated in 1948 and power now sold to Pennsylvania Power and Light was not resold to any customer in Pennsylvania?

* * *

The Witness: I would have an opinion if I did not know [3641] that you also were considering capacity in addition to No. 3 at Riverside, and so is the Bethlehem Steel Company. That puts me in a position where I can not specifically answer your question.

* * *

The Witness: I have an opinion that if the Pennsylvania Power and Light contract were to be terminated and the services were not to be resold that somewhere on the system there would not be the need for some amount of capacity. I don't think it would be as much as No. 3 Unit, but it might approach it.

* * *

By Mr. Goldberg:

Q. When you stated to Mr. Miller that the requirements of the Pennsylvania customers in Pennsylvania could be met, always be met, by Penn Water and Safe Harbor, in answering his question I take it that you included in the source of supply the electric energy output of Safe Harbor and such supply from Consolidated as was coming up to Pennsylvania to supply the [3642] Pennsylvania Railroad. Is that right?

* * *

A. I will try to answer it in two ways. I did take into consideration all of the electric services of Safe Harbor in making that answer. I did not take into consideration, regardless of whether I should have or not, but I did not take into consideration the operating responsibilities of Baltimore Company to the Pennsylvania Railroad for the electric services of the Pennsylvania Railroad in the state of Pennsylvania.

Q. But you did consider that there was available to you all of Safe Harbor's output?

* * *

—despite Safe Harbor's agreement to sell two-thirds of its output to Consolidated under Items E, F and G. Isn't that so?

* * *

[3643] The Witness: I did consider that all of Safe Harbor's electric services, and that includes its output, were available to Penn Water and Safe Harbor to meet their respective obligations, whatever they may be, respectively, to the Pennsylvania customers. I went beyond that and assumed that all of the electric services required by the Pennsylvania Railroad in the state of Pennsylvania were to be met from the electric services available to Penn Water and Safe Harbor without any of the electric services to which Baltimore Company may have been obligated to supply in connection with the railroad supply in Pennsylvania.

* * *

Q. You did that despite the obligations of Safe Harbor to Consolidated for two-thirds of its output to Consolidated. Is that right, under Items E, F and G? A. I did not recognize in my answer that any portion of Safe Harbor's output or electric services went to Baltimore Company.

[3644] Q. Nor did you recognize that it belonged to Baltimore, did you? A. I don't understand that question.

Q. When I said "belonged to Baltimore" I meant Consolidated had paid for it. A. Consolidated paid two-thirds of the revenues to which Safe Harbor is entitled for all of its electric services to whomever it may be rendered.

* * *

[4352] DONALD GUNN.

* * *

Cross-Examination (Continued).

By Mr. Goldberg:

* * *

[4379] Q. In other words, the integrity of the investment in the property resulting from depreciation is maintained when you have provided an annual allowance for the depreciation which is taking place. Is that right?

* * *

THE WITNESS: The question seems to me to be a little bit obscure, but I think that that might be true if you provided it in the right amount, of course.

By MR. GOLDBERG:

Q. Yes, with that qualification you agree? A. Oh, as I understood the question, yes.

• • •

[4384] Q. All right. Let us take a small illustration to develop your thinking. We have the original cost of an element [4385] of property at $1,000. A. Yes, sir.

Q. In providing for depreciation, let us assume zero salvage, Mr. Gunn, to simplify our problem. Now, then, would you provide depreciation for a thousand or for more than $1,000? A. For $1,000 as I understand the regulations.

Q. And you would provide it for only $1,000 even though you contemplated replacing the property when it is retired. Right? A. Yes.

Q. Now, then, let us assume further that replacement will cost $2,000. A. Yes.

Q. Though you estimate that the replacement upon retirement of the existing property will cost $2,000 you would still provide only $1,000 in depreciation. Right? A. Yes, under the Federal Power Commission's regulation.

Q. Because you are providing for the cost of the property over its service life?

• • •

THE WITNESS: Yes, that is what we are endeavoring to do.

By MR. GOLDBERG:

Q. So that your provision for depreciation of the [4386] existing property is only a provision which may be available to the company when it replaces the property. Right?

• • •

[4387] THE WITNESS: I think that is generally correct unless some of the words have some special meaning. It seems to me it is justly stated.

By MR. GOLDBERG:

Q. I was not using any special meaning in the words. A. As I understand your question that seems to be correct.

* * *

[5629] J. RHOADS FOSTER.

* * *

CROSS-EXAMINATION (Continued).

By MR. GOLDBERG:

* * *

[5659] Q. Now, these opinions as to fair return and fair rate of return expressed at transcript pages 649 and 650 were [5660] influenced, I assume, by the data in Exhibit 30, Schedule 11, which were excluded by the Trial Examiner. Is that right? A. Certainly.

* * *

[5666] Q. Now are we to understand that the data in Exhibit 29 influenced your conclusion as to fair return and fair rate of return in this proceeding? A. They did and Schedule 11 of Exhibit 30 presents a diagrammatic view of the process by which it influenced my conclusion.

Q. And the other data in Exhibit 30, as well as Schedule 11, had a bearing on your conclusions, is that right? A. That is right, and I am not aware I presented any data which were wholly irrelevant to my conclusion.

* * *

[5675] Q. No, I mean this: Could you, without a consideration of the data on Schedule 11 of Exhibit 30, have reached a conclusion as to the fair rate of return in this case? A. Without a consideration of that data or of data of [5676] similar nature I could not.

Q. In other words, you must, before you can reach a conclusion as to fair rate of return, consider the "fair value" of the property. Is that right?

* * *

[5678] A. You used the term "fair value". I, of course, do not know what meaning you attach to the term. Assuming that you mean cost of reproduction as such I think, perhaps, it is obvious that cost of reproduction does not provide the only, or even the most appropriate, bit of evidence. We are here concerned with evidence. The starting point was, and subject to the assumption of a prudent investment rate base always would be, the return expressed either gross or net, which would be obtained by applying a rate of return derived on the basis of hypothetical replacement cost or presently experienced cost of capital or some such basis, or derived by applying the original capital cost to the prudent investment. But there remains the question of the reasonableness and adequacy of that result in terms of the facts of the existing competitive society, and those facts are competitive costs.

Now, cost of reproduction is not the best evidence of present-day competitive costs. Other evidence available is the present level of wholesale commodity prices in relation [5679] to levels which existed at the time of the construction of the particular property. That evidence, however, again is general, or is particularly general.

More directly significant is the evidence of the present-day cost of constructing facilities of modern technological design which would be capable of producing the same service or equivalent goods.

Q. In other words, you would not stop with merely a consideration of reproduction cost because that is not necessarily synonymous with fair value, but you would want to go beyond that and consider other indicia of value such as, as you have stated, purchasing power of the dollar, substitute plant costs, and the like. Is that right?

* * *

The Witness: It is true, Mr. Goldberg, that cost of reproduction is not necessarily synonymous with fair value. It is not correct to say, or to imply, that the process of testing to which I have referred is a process of determining fair value. In applying these tests of the reasonableness and adequacy of the return arrived at by use of a prudent investment rate base method we need not be concerned with fair value in the sense of the Smythe v. Ames rule, and it certainly is not an application of that rule or method.

[5680] By Mr. Goldberg:

Q. Well, in reaching your conclusion in this case you did so by tests against data, against plant data, which is other than actual cost. Right?

* * *

The Witness: I did so by tests involving cost of plant which were other than actual costs and by tests involving other price data, and I did so for the reasons which I have just outlined.

* * *

[5766] Q. You are saying that in companies of corresponding risks and uncertainties to Penn Water, investors in common stock of those companies are capitalizing prospective earnings at 8½ per cent. Isn't that so? A. The validity of that proposition, of course, depends upon its validity in the case of Penn Water, which is to be tested by the facts with respect to the Penn Water situation, and which is precisely what I attempted to do.

Q. You did not test it by looking at facts of companies with corresponding risks and uncertainties. Isn't that so? A. Because it would have been a complete waste of my time to resort to secondary and indirect evidence when direct and more adequate and satisfactory evidence is available.

Q. And your answer is that you didn't so test it. Right? A. I so testified.

Q. Now, then, what you did was to determine the appropriateness of your 8½ per cent conclusion by considera-

tion of earnings—price ratios of companies which were not of corresponding risks and uncertainties. Isn't that so? A. That is not true.

[5767] Q. Are they of corresponding risks and uncertainties? A. I have answered that question by saying I have made no study to determine what companies are of corresponding risks and uncertainties.

Q. Then you concluded that 8½ per cent was appropriate by a consideration of earnings-price ratios of companies as to which you made no determination of their comparability from a risk characteristic standpoint to Penn Water. Isn't that so? A. That question has been answered in the negative.

Q. Did you or did you not determine—and I must repeat this because I think that the answer should be "Yes" to my preceding question on the basis of what you told me —did you or did you not determine whether your six companies were of corresponding risk and uncertainty to Penn Water? A. I made no study for the purpose of quantitative measurement of differences in investors appraisals of risk as between the Penn Water common stock and the common stocks of the other six companies. It is true, of course, that the earnings-price ratios expressed as averages over a long period of years give some indication of the difference between investors appraisals of risks in the case of Penn Water and their composite or typical appraisals in the case of the six.

* * *

[5780] Q. Dr. Foster, do investment houses, investment service houses such as Standard and Poor's, in their published analyses of electric utilities, show earnings as reported or as adjusted for non-recurring items? A. The houses to which you refer customarily, at least, in their reports of operations show earnings as reported and compute earnings per share on the basis of the equity income as shown in the income statement in the annual reports to stockholders.

I recall in that connection, however, a paragraph from the book "Security Analyses" by Graham and Dodd, who are recognized authorities, that in situations where the amount of equity income is affected by irregularities such as non-recurring items, or charges to income which should be charges to surplus, or vice versa, the financial services might well give consideration to omitting a statement of earnings per share from their service.

Q. What edition of Graham and Dodd's? A. Second edition. I don't remember what page. Somewhere in the three-hundreds, I suspect.

* * *

[5802] Q. When did the investor first become concerned about regulatory action affecting Penn Water?

Let me limit the question to regulatory action by the Federal Power Commission. A. I believe the date of the order of the Federal Power Commission instituting the rate proceeding was early in the month of September 1944.

Q. Is it your statement that it is only the actual institution of proceedings which caused the investors concern? A. I believe that is generally a valid proposition.

Q. Doesn't the prospect of regulatory action cause him to reflect his concern in the earnings-price ratios? A. The prospect of regulatory action, or the possibility of regulatory action continually exists in the case of any enterprise which, because of its characteristics, is subject to the exercise of legislative power in the peculiar form in which that power is exercised in the case of what we know as public utilities.

That possibility exists even before a particular enterprise or enterprises of a class have been in fact designated as public utilities. When they have been so designated and the legislative power has been delegated to a regulatory Commission that prospect of regulatory action, of course, is less remote.

[5803] But investors generally do not readjust their thinking until something occurs which makes action leading to a

possible reduction of rates immediate or definitely in prospect.

* * *

[5804] Q. This is what I get out of your answers. The prospect of regulatory action exists continually. Right so far? A. In the case of enterprises of this type it does.

Q. And since it exists continually doesn't that mean that the earnings-price ratios continually reflect the investor's apprehension, if I may put it that way, of regulatory action, but that it is reflected in various degrees in the earnings-price ratios to a lesser extent when the prospect is remote, to a greater extent as the prospect becomes less remote. Right? A. That is true. I think, however, until the prospect becomes one of relative immediacy because of the implementation of regulatory power no significant consideration is in fact given to it.

* * *

[5818] A. * * * I think the point of significance in connection with your question is that it is the institution of the proceedings which raises the questions, yet to be answered by the conclusion of the proceeding, which created the uncertainties and which has the disadvantageous effect on investor appraisals.

The conclusion of a proceeding, whether a proceeding of this nature or a proceeding with respect to rates, tends to [5819] substitute certainty, however bad the prospect may be, for uncertainty.

So if the pendency of the licensing proceeding has an adverse effect on market prices because of the investor's concern with what might happen, I would expect that influence to be evident in the period following the institution of the proceeding.

The chart shows that following November, 1939 the earnings-price ratio for the Penn Water common stock rose steadily and continued to rise until I believe December of 1941. That movement was in response to general conditions. It was accompanied by a similar movement of

other earnings-price ratios and, therefore, is not to be explained by this unique situation affecting Penn Water.

One more step: It also is evident from the chart that the Penn Water earnings-ratio moved from a position below the average to a position above the average. That behavior, however, is characteristic of the earnings-price ratios for common stocks in the case of which the equity is thin and the leverage is substantial or the risk is considered by investors to be relatively larger because of any other factor, and it may be observed that from the period from 1933-1934 to 1935-1936, the same kind of behavior is observed except that the movement is from a position above at the time of relatively low prices to a position below at the time of relatively high [5820] prices.

* * *

[5821] A. I testified that in my opinion the comparative behavior of the Penn Water earnings-price ratios is accounted for as between these cyclical movement by its character as investment opportunity, referring particularly to the leverage position of the equity, and I have reached that conclusion because of my general knowledge of the behavior of earnings-price ratios of common stocks in various positions with respect to capital structure and because of my observation of the behavior of this common stock in relation to other common stocks at various times in the case of some of which the consideration to which you referred was not present.

Q. Are you saying that the 1939 proceeding did not influence the earnings-price ratios, the earnings-price ratio behavior, shown on Chart 1 of Exhibit 29 during the latter part of 1939 and through 1941? A. No. I am saying definitely and unequivocally that there is no evidence that it did influence the behavior of the earnings-price ratios significantly in relation to the influence of other factors which account for the amplitudes of variation.

Q. How can you say that there was no significant influence on the behavior of Penn Water's earnings-price ratios

subsequent to 1939 when prior to that time the [5822] fluctuations of Penn Water's earnings-price ratios had been above and below that of the six companies? A. I said there was no evidence there was any significance.

Q. How do you arrive at the conclusion there is no evidence of a significant influence? A. Because the behavior is more rationally explained by consideration of other influences.

* * *

[5833] Q. That is not the fact when you look at 1937 to 1939. Part of the time the line for the six companies is above Penn Water and part of the time it is below, and if you look over [5834] at 1922 to 1928, throughout that period of time the earnings-price ratios for the six companies is always above those of Penn Water? A. That is true with the reference to the particular periods which you have identified.

Q. Yes, and market prices were low during those periods and yet the earnings-price ratios of Penn Water were not proportionately higher than those of the six companies. Isn't that so? A. Market prices were relatively lower than at other times and during parts of the periods the Penn Water earnings-price ratios were relatively lower.

* * *

[5838] Q. Isn't this the fact: Other things being equal, the investor in common stock will pay more for that stock which pays out in dividends a larger percentage of the earnings available for common and in which the percent of gross income available for equity income is higher? A. That is a statement of two separate tendencies, each, I believe, being the typical behavior.

Q. That is why I said "other things being equal." A. I referred to it as two separate tendencies because the two variables which are identified here are independent of each other and, of course, may not operate in the same direction in any one case.

Q. The figures we have been examining, that is yours given on direct on pages 539 to 541, and those I have given you from 1939 to 1945, inclusive, indicate, do they not, that the percentage for Penn Water, the percentages for Penn Water, are at least as favorable, if not more so, than the percentages for the four of the six companies, speaking, [5839] of course, from the investor point of view? A. So far as these two factors are concerned and their influence, if indicated by reference to the typical influence, the answer is "yes."

Q. Yes. In other words, we cannot look to the factors involved in a comparison of these percentages for the differences in the earnings-price ratios from 1939 to 1945 between Penn Water and the medial four of six companies you used in Chart 1 of Exhibit 29. Isn't that so? A. That is true. In presenting these percentages it was in no way my intention to attempt to explain those differences.

Q. What other factors could explain that difference in earnings-price ratios between Penn Water and the medial four of six companies in the period 1939 to 1945? A. I can answer that kind of a question only in terms of possibilities and probabilities.

Q. If that is the only way you can answer that I will have to take your answer that way. A. The investor's appraisals of the Penn Water investment opportunity reflect, of course, all of the factors which in his opinion influence or may influence the prospective income and the stability of that prospect. Size of enterprise in relation to size of other enterprises is such a consideration. [5840] As a typical or general proposition some advantage exists as a result of increasing size up to certain limits only.

The investor is concerned, in the appraisal of any such opportunity, with the character of the market served. The favorable market characteristics are those which include the maximum prospect of growth. Also, of course, the character of the demands are significant, demands of differ-

ent types of users having divergent relationships with business cycle and other influences.

The exposure of the facilities and, consequently, the investment to physical hazards is a factor.

We touched earlier today upon the question and comparative effect of exposure to regulatory action. The quality of the management of the enterprise is a consideration.

Those are among the factors which, as a matter of business judgment, are considered in making investment choices.

Q. In other words, we must look to these factors to find an explanation if it exists for that differential shown on Chart 1 of Exhibit 29 in the earnings-price ratios of Penn Water in the form of six companies in the period 1939 to 1945, inclusive. Is that right? A. The explanation of the differential exists in the composite investor judgment. I am merely identifying these [5841] factors which commonly enter into the formulation of that judgment.

* * *

[5846] Q. Am I correct in drawing this conclusion as to your statement on size of enterprise? While increase in size is a mixed blessing, the blessing involved in increasing size overcomes any additional hazards, responsibilities and risks which may be involved due to increases in size? A. Undoubtedly, and in overwhelming degree at the levels of size customarily experienced.

* * *

[5854] A. Proportion of gross income available as equity income, expressed as the average for the years 1939 to 1945 inclusive, is 72.1 per cent for Penn Water.

For the group of four other common stocks, consisting of Commonwealth Edison, Consolidated Edison, Consolidated Gas of Baltimore, and Detroit Edison the average is 65.6.

[5855] Referring now to the dividend earnings ratio, or per cent equity income paid out as dividends, I have an average of 83.5 for Penn Water.

The average for the group of four common stocks which you supplied to me, consisting of Boston Edison, Consolidated Gas of Baltimore, Detroit Edison, and Pacific Gas and Electric Company, is 83.3 per cent.

* * *

[5856] Q. Yesterday we discussed at some length your views with respect to the effect on earnings-price ratios for Penn Water of the Federal Power Commission proceeding which involved Penn Water's right to operate its hydro-electric project without a license, and my recollection is that you testified that you did not consider the influence of that proceeding had any significant effect on the earnings-price ratio. Is that a fair statement? A. I believe so.

* * *

The Witness: I testified there is no evidence it had a significant effect and that the behavior is more rationally explained by consideration of other influences.

* * *

[5885] Q. I would like to know if you determined the reasons for the differential between the earnings-price ratios of the medial four of six companies and of Penn Water in the period 1939 to 1945, which differential appears on Chart 1 of Exhibit 29? A. The reason for the differential was stated generally at an earlier point in the testimony. The earnings-price ratios of common stocks, regarded by investors as relatively risky common stocks, fluctuate much more widely with changing securities market conditions than do the earnings-price ratios for common stocks regarded by investors as having a relatively stable prospective income.

Q. And you say that is the reason for the difference in the period 1939 to 1945 on Chart 1 of Exhibit 29. Is that it? A. I say that that behavior is a fact and that that presents the only rational explanation of the behavior during that period.

Q. It is your statement that the investor looked upon [5886] the medial four of six companies as having more

stable prospects of income than Penn Water. Is that right? A. That is correct.

Q. Which of those six companies that you studied have an assurance of a definite amount of income, whatever it may be, up to 1980? A. No one of the six companies has either definite assurance or guarantee of income stable in amount to 1980 on or to any other remote date.

Q. But Penn Water has that, hasn't it? A. It does not.

Q. Did you know that Penn Water has a contract which assures it until 1980 a fixed amount of income, even after adjustment by a regulatory commission of the extent of the rate of return? A. I am certain that in any economic or financial sense the contract to which you refer does not provide for Penn Water a guarantee or definite assurance of income to the year 1980. I am equally assured that the investors do not so regard the Penn Water contract.

[5887] Q. Your own notes to Schedule 2 on Exhibit 29 on page 8 reflect the company's statement that its contractual arrangement with Consolidated constitutes virtually a guarantee of earnings on its capital stock. Isn't that so? A. The note to which you refer is within quotation marks and is an excerpt from the annual report of the company.

Q. Yes. And your own notes, which you included as a background to your considerations, show exactly what I have just stated. Right? A. The excerpt includes the words which you have used.

Q. Which of those six companies can say that? A. No one of the six companies is either a wholesaling company supplying a limited number of customers or a company having a contract of this form.

Q. None of those six companies have that type of stability of earnings; right? A. None of the six companies has a contract of this form, nor does any one have whatever additional stability of income would be provided by such a contract.

Q. You know, don't you, that the earnings of the six companies are dependent upon economic cycles, business

cycles. Is that right? A. The earnings of the six companies in the composite are influenced by business cycle changes.

Q. You know that is not the fact with respect to Penn [5888] Water. It can sneer at depressions. Right? A. Under the form of the contract, as long as that contract remains effective and operative, the earnings available to the equity of Penn Water tend to be stabilized.

Q. The stability of the earnings of Penn Water are shown beyond doubt, aren't they, by the dividend records of the company throughout the depression?

• • •

The Witness: The dividends paid per share by Penn Water were maintained without change at $3 per share from 1929 to 1934 inclusive.

By Mr. Goldberg:

Q. How about the six companies? How many of them maintained a record like that? A. I would have to examine the facts to answer the question specifically. The dividends paid by Boston Edison, which in 1929 were $12.80, declined to $9 in 1934.

The dividends of Commonwealth Edison Company, which in 1929 were $8, declined to $4 in 1934.

Dividends of Consolidated Gas of Baltimore, which in 1929 were $3.60, remained unchanged.

[5889] Mr. Sparks: You mean non-changed through 1934?

The Witness: Yes.

Mr. Goldberg: Let me interpose here.

By Mr. Goldberg:

Q. That is the company which has the contract which runs until 1980 with Penn Water, isn't it? A. I believe Consolidated of Baltimore is a party to the contract to which you refer.

Q. A pillar of strength, isn't it? A. Is the contract a pillar of strength to the one who receives the benefits and to the ones not benefited?

The dividend of Consolidated Edison of New York declined from $4 in 1929 to $2 in 1934.

Q. Do you have your dividend rate for 1935? Didn't it fall below $2? A. Yes, in 1935 in the case of Consolidated Edison the dividend rate was $1.

I have not checked any split of the common stock in the case of that company.

Q. I think there was a split on Boston Edison of four for one. A. At a later date?

Q. At a later date, I think, and Standard and Poor's show dividend rates of $3.10, for example, for 1929. And $2 for 1936, for example. That would indicate a split-up. [5890] A. I should have prefaced the reading of these figures by the explanation that they represent the annual rate at which dividends were being paid at the end of the year.

In the case of Detroit Edison the dividend rate was $8.

Mr. Sparks: In 1929?

The Witness: Yes, in 1929. It was $4 in 1934.

In the case of Pacific Gas and Electric Company the dividend rate was $2 for 1929 and $1.50 in 1934.

I believe 1934 represents the lowest level which was reached in that decline of dividend rates and that after adjustments were made for split-ups the rate increased in subsequent years.

• • •

[5891] Q. Wouldn't you say that an investor, an informed investor, considers the reports put out by Standard and Poor's as stock guide reports and bond guide reports? A. That service is very well-known and widely used and I have no doubt that investors consider it.

Q. I want to show you the latest Standard and Poor's report on the stock and bonds of Pennsylvania Water and Power Company, which is dated August 23, 1946, and ask you if it is not a fact that under the caption "Prospects" it is stated that "The company's contract with strong Consolidated Gas of Baltimore results in fairly stable earnings." A. I read the sentence which you have quoted.

Q. Would you refer to Consolidated Gas of Baltimore as a strong company? A. Consolidated Gas of Baltimore is an electric and [5892] gas utility serving a metropolitan area and generally a strong company in the sense that it is regarded by investors as a company with better than average prospects so far as income stability is concerned.

Q. It also states under that caption I have referred to, doesn't it, that, "One uncertainty in the outlook is the possibility of regulatory pressure upon the high rate of return"? A. It does.

Q. Do you agree with that statement? A. Certainly.

* * *

[5895] Q. Under the caption "Earnings determinants", it is stated, is it not, that "A ready market for all power and fixed earnings well above debt requirements are assured by the [5896] power contracts. Most of these extend beyond the bond maturities. While regulatory pressure may result in lower power rates, since the return on property is high, fixed charges would still be earned by adequate margins."

It so states, isn't that so? A. It does.

[5897] Q. These reports from which we have been reading are available to the informed investors, aren't they? A. They are available to investors and I believe are examined by some investors.

Q. I think you would agree that the reporting service is an unbiased one? A. I have every reason to agree with that statement.

Q. And its purpose is to present information to the investor to give him pertinent facts upon which to base a decision with respect to alternative opportunities for investment. Right? A. I believe that is a purpose.

* * *

[5931] A. As a proposition standing by itself it is true that more recent experience is entitled to more consideration as a guide to the probable future than is experience remote in time.

* * *

[5966] Q. And there are statements on pages 107 and 125 which show that not only did the study proceed on the theory that the most recent reports of operations and financial management are given the greatest weight, but that the results of your studies confirm the opinion that investors give the greatest weight to the most recent operating results and that the results of previous years are given progressively less attention as they become more remote. Isn't that so? A. That is as it appears in the report and I believe is correct as a general statement.

Q. What qualifications would you put to it now? A. Investors give to the reported results of operations of recent years greater attention in considering future possibilities than they give to the results of operations as reported for more remote years.

We have expressed generally the proposition that the future is unknowable, that nevertheless the market price reflects the appraisal of the prospect of income in the future.

Therefore, I believe the statement which you quoted is valid. I would not so much qualify as to point out that it is far from, and did not purport to be, a complete statement of the manner in which past earnings for the more recent period is used by investors and by analysts in the process of estimating the future.

[5967] Q. In other words, how they use it quantitatively. A. In arriving at specific estimates, yes.

In that same connection it might be pointed out that the appraisals, of which we are now speaking, reflect the appraisal of future income and correspond to the capitalization rates. We are not speaking of the earnings-price ratios, and the conclusion that the results of recent operations are more significant to the investor in forecasting the future in no way invalidates the proposition that a full cycle must be considered.

Q. I was not implying any challenge to that, but the fact remains that in your study in this case you gave equal weight to 1939 earnings-price ratios, which were included

in your cycle, and to the earnings-price ratios of 1945, which were included in your cycle, and to the earnings-price ratios of all intermediate years in that cycle. Isn't that so?

THE WITNESS: May I ask for clarification?

MR. GOLDBERG: Yes.

THE WITNESS: You are now referring to the——

By MR. GOLDBERG:

Q. Chart 1 of Exhibit 29? A. Earnings-price ratios of Penn Water?

Q. That is right. A. I did arrive at the conclusion on the basis of an average which involved giving equal consideration to each [5968] period within the cycle, with the qualification as to the treatment of the Penn Water earnings-price ratios after September, 1944.

• • •

Q. At transcript 516, lines 20 to 24, you testified that the replacement cost concept, as you use it, includes the assumption that the enterprise is a going concern, but [5969] necessary and unavoidable costs are associated with achieving the status of a going concern in a position to obtain capital on the basis of a hypothetical capitalization. What are these "necessary and unavoidable costs"? A. The replacement cost concept is a reflection of the competitive or present cost approach to the problem. Assuming for the purpose that regulation seeks to provide for the regulated enterprise two things: First, all the advantages which are associated with the exclusive right to serve within a given service area, which are substantial and significant advantages. Secondly, that at the same time it seeks to avoid monopoly returns.

It is a cost concept and would limit the returns to those which would be realized if the enterprise were in fact competitive and if the competition were effective.

Now, what is the actual situation as to the functioning of competition? A number of enterprises establish themselves in a particular line of endeavor. They manufacture

tin cans, for illustration. They have as going concerns certain advantages over a new enterprise which would come in and afford increased and additional competition on the basis of improved methods, or whatever other advantage may become available to such a possible competitor.

But to some extent offsetting the economies thus available which will result in a reduction in the price of the [5970] product, everything else being equal, is the fact of the costs associated with becoming a going concern.

I did not place emphasis on those costs. I, however, did call attention to the consideration in connection with Schedule 10, that is the overall capital cost rate of 4.9 per cent, defined as a hypothetical replacement cost rate, includes no cost of replacing existing capitalization. It assumes freedom to obtain capital represented by a particular capital structure of maximum economy without including any costs associated with an existing capital structure.

* * *

[6002] Q. I would like to direct your attention to a statement appearing on page 23 of the Federal Communications Commission's report on the problem of the rate of return and public utility regulation which we referred to this morning, page 23 being a part of Chapter II. The statement is as follows:

"The historical cost of fixed income capital may be calculated directly from the corporation's accounting records, and may be expressed as a ratio between the annual obligations and the proceeds realized by the company from the security issues in question.

"With respect to common stock capital, a different situation exists. When the stock was sold no contractual or fixed rate was established. The very essence of the situation of common stockholders is that they are entitled [6003] to the earnings remaining after all other items have been deducted and only to such earnings. Common stock is necessarily purchased by the investor subject to this quali-

fication, and it appears that there can be no assumption of fixed rate to be paid throughout the future. Without such a rate the historical cost of this class of capital cannot be calculated."

Do you agree with the statements I have read? A. I do generally.

Q. What qualifications do you make? A. None if it is understood that the statement which you read means that a historical cost rate cannot be calculated for equity capital in the sense that such a historical cost rate can be calculated for debt, and preferred stock capital.

Q. I understand—— A. It is true that the return expectations and cost of equity capital can be estimated at the time of commitment of equity capital.

I am making a distinction between the words "estimated" and "calculated".

Q. You agree that common stock is necessarily purchased by the investor subject to the qualification expressed in the statement that the very essence of the situation of common stockholders is that they are entitled to the earnings remaining after all other items have been deducted, and only [6004] to such earnings? A. That is right.

Q. And that it appears that there can be no assumption of the fixed rate to be paid throughout the future? A. That is right.

Q. Now I would like to direct your attention to this statement appearing on page 23 of that same report and continuing on to page 24. The statement is as follows:

"It has been contended by some investigators that a historical cost of common stock capital may somehow be computed by reference to the dividend rates prevailing at the time the stock was sold. This approach assumes that the investors purchase the stock on the basis of these dividends, and with the expectation that they would be continued indefinitely. If dividends are increased it is stated that past investors are not entitled to this increase, and that the cost of capital attributable to their shares should

be figured at a different rate from the cost of capital derived from any new shares sold.

"It appears that this approach ignores the fundamental characteristic of common stock as the claimant of residual earnings. If common stock did in fact bear fixed dividend rates, the historical cost of such capital could be computed, but when dealing with stock without such fixed costs it appears that the current cost approach must be adopted so [6005] far as this class of investment is concerned.

"This problem of the determination of proper costs in respect to common stock capital will be given detailed consideration in subsequent sections of this report."

I think we can ignore the last sentence. Ignoring that last sentence about detailed consideration do you agree with the statement I read? A. I do.

* * *

[6006] Q. I refer you to Page 28 of the FCC report. May I draw your attention to this statement: "In any event, in so far as the return on common stock capital itself is concerned, the current cost approach appears to be the better method of measurement. Indeed, as was stated previously, this approach seems to be the only logical possible one. Furthermore, it appears to be an essential characteristic of common stock that returns are variable. Investors who primarily want secure, relatively low incomes will turn to other classes of securities. Common stock investors are those most willing to bear risks, and, as a class, probably expect their incomes to vary with changing economic circumstances.

"The legal position of common stock as the claimant of all residual earnings also tends towards a fluctuating income. And, most important, it is usually possible to vary the return on common stock without adversely affecting the company's credit.

"There might not be serious disagreement that it would be desirable for the rates of return on all classes of secu-

rities to vary with changing economic conditions, if such variations did not adversely affect the company's credit position in the case of securities with fixed income rights."

Do you agree with those statements? A. I do with the qualification that I would desire to [6007] give more consideration to the meaning of the last two sentences which appear here.

I do agree generally with what is stated here, particularly because the reference is to the return on common stock capital and not to the rate of return.

Q. Were you making a distinction in your last answer between return on common and rate of return on common or between return on common and rate of return on the rate base? A. I am making a distinction between rate of return on the common stock equity represented in the rate base and return on common stock equity. In the case of a utility with only common stock equity there is no difference as a result of that distinction.

Q. What is the difference when a company is not entirely capitalized with equity capital? A. There is a tremendous difference. The return is the product of the rate of return applied to whatever may be the rate base.

Q. And your rate of return takes into consideration a return on the equity capital. Right? A. The overall rate of return includes a component which represents rate of return on equity capital. The amount of return provided for the equity capital is significantly dependent upon the rate base to which that rate of return is applied.

* * *

[6027] Q. Wouldn't you say that arithmetic averages are of doubtful validity? A. I would say that the validity of arithmetic averages [6028] depends upon the nature of the data, upon the understanding with which the averages are used and upon the purpose for which they are used. I agree that often arithmetic averages are used improperly and may be of doubtful validity for a specific purpose.

Q. Their doubtful validity arises from the fact that the average tends to obscure the variations in the individual figures from a certain "norm". Isn't that so? A. That is true. An examination of the average as such does not reveal anything that is back of the average or is represented by it.

* * *

[6036] Q. Did you know that the major portion of Penn Water's common stock was issued either as bonus stock or in exchange for bonds? A. I believe so. I am not informed as to the exact proposition.

Q. About 85,000 shares? A. Yes.

Q. Under such circumstances there would have been no underwriters' discounts and commissions. Isn't that so? A. So far as the issuance of the common stock is concerned?

Q. Yes. A. That is correct.

Q. That would indicate that the actual cost to Penn Water as financing costs is far less than .75 per cent. Isn't that right? A. So far as cost of equity capital represented by that block of common stock is concerned.

Q. Assuming 8.51 per cent is the correct equity capitalization, and adding .75 per cent to it, aren't you actually giving the common stockholder more than 8.51 per cent if the company had not incurred the cost of .75 per cent for financing?

The Witness: May that question be read, please?

[6037] Trial Examiner: Yes.

(Question read.)

The Witness: The question is not clear to me. The 8.5 per cent is an estimate of the required yield on equity capital on a hypothetical replacement cost basis. The 9¼ per cent is an estimate of the cost of equity capital on the same basis.

Q. But Penn Water never experienced that .75 per cent insofar as the equity capital was concerned that we have discussed, so there is no occasion to increase the 8.51 per

cent by .75 per cent. Isn't that so? A. It would be necessary to recognize and allow for the cost of equity financing for the purpose of arriving at an estimate of the total cost to an enterprise of such capital.

[6038] Q. Even though such costs had never been experienced by the company? A. The definition of hypothetical replacement cost specifically excludes recognition of and measurement of past cost.

Q. You have not assumed that Penn Water would redeem its bonds and issue equity capital in lieu thereof, have you? A. I have not made any assumption as to what Penn Water may actually do.

Q. In determining the cost of the issues of bonds of Penn Water, isn't it a fact that you have carried forward as expense of the refunding issue amortized debt discount and expense incurred when the refunded issue was first plotted? A. That is correct.

Q. I think you did that with respect to Penn Water's 1940 issue of bonds. Right? A. I believe so.

Q. You know that was not in accordance with the accounting Penn Water carried out for that debt discount and expense pursuant to the requirements of the Federal Power Commission, do you? A. I do know that.

* * *

[6048] Q. What would have been the cost of the bonds of Penn Water if you had not carried forward the unamortized debt discount and expense which we were discussing at the close of yesterday's proceeding and which unamortized costs appear on Schedule 4, page 3 of Schedule 4, of Exhibit 29? A. They appear on page 3 of Schedule 4 as Item 49, I believe.

Q. Yes. A. I have in pencil on my copy of that exhibit such a computation which shows for the series due 1964, a cost of 3.21 per cent, and for the series due 1970, a cost of 3.13 per cent.

Q. Yes, we had 3.14. That is close enough.

* * *

[6049] Q. Would it be fair to say that the average of the 3.21 and the 3.13 is 3.17? A. I have not determined the average. It undoubtedly is within that range of .08.

Q. Yes, I think you probably recognized that I included the word "fair" because I recognize sometimes weighting factors are involved, but I didn't think any weighting factors here would have any significant effect. Is that right? A. I belive you are right.

* * *

[6565] DONALD GUNN,

* * *

CROSS-EXAMINATION (Continued).

By MR. HALL:

Q. Are you the same Mr. Gunn who testified in this matter previously? A. Yes.

* * *

[6566] Q. Are we to understand that you are responsible for Exhibits 25, 26 and 27? A. I am responsible in the sense that I had supervision over the preparation of them, yes, sir.

Q. When you say you had supervision do you mean that you are prepared to answer questions with respect to the determinations of the matters shown in those exhibts? A. Yes, to the extent that I can recall them at present. [6567] However, I would like to say this: That Exhibit 26 has about 125 typewritten pages in it. Exhibit 27 has nearly 500 pages in it. They were prepared seven and eight years ago. My memory of all the details may be somewhat limited but I am prepared to go as far as I can.

Q. Have you reviewed those exhibits in connection with this proceeding? A. Yes, sir, I have reviewed them but I have not had an opportunity to review them as much as I would like to have.

Q. Is anyone else responsible for a portion of these exhibits? A. I am afraid I don't understand what you

mean by "responsible." Are you using the word in the same sense as you did when you asked me if I were responsible?

Q. Even though someone else or others may have assisted in the preparation of those exhibits, you are taking the ultimate responsibility as I understand it? A. Yes, with their assistance.

Q. As of what date did you begin your original cost study?

Mr. Sparks: You are now referring to the items "K" to "N" Mr. Hall or to Exhibit 25?

Mr. Hall: Total original cost study, wherever it may be reflected in the exhibits.

Mr. Sparks: Including the Items "K" to "N"?

[6568] Mr. Hall: Yes.

The Witness: May I have the question now, please?

(Question read.)

The Witness: During the latter part of 1937 or the early part of 1938.

By Mr. Hall:

Q. As of what date was your study completed? A. I believe it was completed and filed in either May or June, 1940.

Q. How many were assigned to make the original cost study? A. The force engaged on that study varied from time to time. As I recall it, it ran as high as 30 or 35 men.

Q. How many of them were accountants? A. Of the people who devoted their time exclusively to the original cost study there were either three or four accountants.

Q. Who were they? A. Mr. William H. Eichhorn, Mr. Frisch—I don't believe I recall his initials now—Mr. Frederick Stupp. Those were the ones who devoted all of their time to the study.

In addition to them there was Mr. O'Connor, who advised me on certain phases of it and devoted a part of his time.

Q. Were the four individuals that you have named, Eichhorn, Rich, [Frisch] Stupp and O'Connor employees of Penn Water? [6569] A. Yes, sir.

Q. What positions did each one of those individuals hold? A. You mean what positions did they hold at the time of the study or now?

Q. That is correct, at the time of the study. A. Mr. Eichhorn was simply assigned to work on the original cost as my assistant. I don't remember he had any specific title.

Q. Was he an officer of the company? A. He was made an officer of the company near the completion of the study. It may have been after the completion but it was about that time.

Mr. O'Connor was, I believe, Vice President and Secretary of the company at that time.

Mr. Frisch and Stupp were simply employed by the company simply for the original cost study. I don't recall they had any particular title.

Q. Was their employment terminated upon the completion of the study? A. Yes.

Q. Did Pennsylvania Water and Power Company issue a work-order providing for the original cost study? A. I believe they did, although I am not certain of that.

Q. My information, Mr. Gunn, is that the work-order is [6570] Number M-1711. Does that check with your recollection? A. Yes, I believe I recall that.

Q. According to my information, Mr. Gunn, there was a total of $229,000 which was incurred pursuant to that work-order up to December 31, 1942. Does that check with your figures? A. That sounds like about the amount.

Q. You have referred to accountants who assisted in the preparation of your original cost study. Which one of those accountants was responsible for the decisions in connection with accounting matters? A. I don't know just

how to answer that for this reason: Mr. Eichhorn gave me certain advice on accounting matters, and so from time to time did the other accountants. I also looked to Mr. O'Connor for my guidance on the treatment of accounting problems, and most of them also were discussed with company counsel. So I can not categorically state, I believe, who was generally responsible for the accounting decisions.

Q. Could you indicate one of the principal accounting problems you faced? A. I don't recall offhand any particular problem. It was just a multitude of small accounting questions which arose and upon which I had the advice of the accountants and the advice of the company counsel.

Q. Don't you recall some specific problem that required [6571] accounting consultation? A. No, I don't believe I do recall any.

Q. When you completed and submitted your report, Exhibit 26, to Mr. Walls was it accompanied by a letter of transmittal?

* * *

The Witness: It seems to me it was, although I don't seem to have a copy of it in the report.

By Mr. Hall:

Q. The copy of Exhibit 26 which I have, Mr. Gunn, appears to contain a copy of your letter of transmittal, which copy appears to bear your signature and is dated August 20, 1940. Is that right? A. Yes, sir, that is correct.

Q. In your letter of transmittal you state that the report, Exhibit 26, superseded a previous draft of the early history of Penn Water. Is that correct? A. Yes, sir, that is correct.

Q. As of what date was the previous draft completed? A. I don't know. The way this Exhibit 26 developed was piecemeal over a period of two years, and at all times we had parts of a draft from the very beginning, and the preparation of the report simply increased. As more facts came into our [6572] hands we incorporated them. As I

recall it, it was a loose-leaf book affair. It wound up in the form you see it here in this exhibit.

Q. Wasn't the previous draft you referred to a complete draft? A. Well, for a time prior to the date of this letter we had a complete draft. As I recall it, it was very badly marked up with numerous revisions and numerous adjustments in it.

Q. Was this previous draft you refer to the first draft prepared covering the early history of Penn Water? A. As I said, there was no category of drafts. It was simply a process of evolution by which this was developed.

Q. Who prepared the various parts comprising the total of the previous draft? A. I prepared some. Mr. Eichorn [Eichhorn] prepared some. Mr. Chase prepared some of them. We all worked on them together at various times.

Q. Will you specify what parts each one of the individuals you named were responsible for? A. I don't think either one of the individuals I named had total responsibility for any part of it.

Q. Didn't they have total responsibility except for your overall supervision? A. If that can be called total responsibility I suppose [6573] they did. However, I did, myself, devote a considerable part of my time to the development of the history of the McCall Ferry project, and the three of us worked on the thing together and simultaneously. In the end, when we had the draft of the story in substantially complete form, we took it to company counsel and went over it with company counsel.

Q. What was the purpose of taking it to company counsel? A. To advise company counsel as to what the story was so they could in turn give us legal advice on the filing of the original cost claim.

Q. Who is the counsel you refer to? A. Simpson, Thacher and Bartlett; Snyder, Hull, Leiby and Metzger; Mr. Dozier A. Devane, who was formerly General Solicitor for the Federal Power Commission. I understand he is now a Federal Judge.

Mr. Goldberg: In Florida.

The Witness: There was also Mr. Hambright, of Lancaster, who was one of company counsel who advised with us.

By Mr. Hall:

Q. Did the criticisms and comments you received from company counsel cause the rewriting of the previous draft into the form embraced in Exhibit 26? A. No, I don't think so. As I recall it, the draft we had when we discussed it with company counsel was already so badly marked up and mutilated it was necessary to rewrite it [6574] for that reason as a result of my own corrections.

Q. What matters covered by the present draft incorporated in Exhibit 26 were not covered in the initial draft? A. Well, some of the things that weren't covered was the information obtained from various people who had been connected with McCall Ferry Power Company, that is the subject matter of the affidavits of Fisk, Hutchinson, Lee, and the other people who had been connected with the original development.

* * *

[6575] Q. Do you consider, and were Exhibits 26 and 27, prepared as support for Items "K" to "N"? A. Yes, I think they could be so described.

Mr. King: Excuse me, Mr. Hall. I think the record ought to show, and I believe you will agree with this, that both Exhibits 26 and 27 were furnished to the Commission staff.

Mr. Hall: I think there is a statement somewhere in the record to that effect.

When were they furnished to the staff?

[6576] The Witness: Within the first month or six weeks, I would say, after the Commission staff came to the company's office for the purpose of preparing for the Commission's presentation of the Safe Harbor rate case. I think that was somewhat over two years ago.

By Mr. Hall:

Q. Can you fix the date of that occasion? A. Only in my memory. I just recall they had been there some weeks before they asked for it. As I recall it, Mr. Dunn requested them. He came to me and said he was ready to start on his accounting preparation of the Pennsylvania Water and Power Company case and asked me what information I had. I gave him Exhibits 26 and 27.

Q. Are you sure you gave the Commission accountants Exhibit 27 along with Exhibit 26 at the same time, or did the Commission staff have to ask for Exhibit 27? A. It was not my intention they should have to ask for it. I don't recall.

* * *

By Mr. Hall:

Q. Mr. Gunn, why were you selected to prepare the report represented by Exhibit 26? A. I don't know.

[6577] Q. When were you initially employed by Penn Water? A. I don't recall that. I was employed by Safe Harbor in October, 1930, and from the time of my employment with Safe Harbor I performed certain duties for Penn Water. I believe in the middle thirties, probably 1934 to 1936, the company began the practice of allocating part of my salary to Penn Water. I don't know which one of those events would determine any first employment in the sense you ask the question but those are the facts.

Q. In what capacity were you initially employed by Safe Harbor? A. To assist in the construction of the Safe Harbor project. I was in charge of the field-work.

Q. What positions have you held subsequent to the date you have mentioned with Penn Water and Safe Harbor? A. I have been assistant chief engineer of both companies and I am now chief engineer of Penn Water and assistant advisory engineer of Safe Harbor Water Power Corporation.

Q. As of the date you began your original cost investigation, how many officers, directors and employees did

Penn Water have who had been with the company since 1910?

[6578] The Witness: May I have the question?

(Question read.)

The Witness: I don't know. That could be determined.

Mr. Hall: You know some.

The Witness: Yes, some, but not all that category.

By Mr. Hall:

Q. Will you state the ones you do recall? A. Mr. Walls, Mr. Rintoul, Mr. Allner, and I believe Mr. O'Connor. Those men were among the officers. Of course, Mr. Aldred had been there from the beginning, and there were undoubtedly some other members of the board of directors who had been, although I don't recall offhand who they were.

My difficulty is I don't recall who were on the board of directors in 1936. Among the employees there are several old employees. I don't know offhand who they all are.

Q. Were any of the six individuals you have named connected with the Holtwood project while McCall Ferry Power Company was carrying on the activities in connection therewith? A. None of them so far as I know. I think I can say none of them were. I am certain of that.

Q. Do you know whether or not the employees were canvassed to determine their early connection with McCall Ferry and Penn Water?

Mr. King: May we have a little better limitation on that [6579] question? Canvassed when?

Mr. Hall: When the original cost study was undertaken.

The Witness: I made an effort to determine what employees there were available either then employed by Penn Water or otherwise from whom I might be able to get in-

formation about the early history. I recall that I attempted to locate the records of Mr. Ehle, who had been connected with the McCall Ferry Company. I believe I also contacted a Mr. C. H. Anderson who had been a general foreman on the McCall construction. There were one or two other people I believe I succeeded in locating when I was making an effort to get at the technical facts relating to the history of McCall Ferry Power Company.

By Mr. Hall:

Q. Can you state why it was that one of the older employees or officers was not selected to prepare Exhibit 26? A. No, I cannot.

Q. Or the original cost studies? A. No, sir, I cannot.

Q. Wouldn't their personal knowledge of the early events place them in a better position than you to prepare the reports? A. I don't think so, because I had the benefit not only of their knowledge of it but all the people who I could [6580] find who had been connected with the McCall Ferry Power Company.

Q. I believe you testified you first became connected with Penn Water between 1930 and 1936. Is that right? A. Yes.

Q. Accordingly you have no personal knowledge of the early history of Penn Water? A. That is right.

Q. But other individuals did have personal knowledge of the early history of Penn Water. Isn't that so? A. Yes, I imagine so. I imagine they also had something else to do besides making original cost studies.

Q. That was true of you, too, wasn't it Mr. Gunn? A. I don't know. I couldn't be too sure of that. Work was rather scarce at that time.

Q. Is that why you were selected, Mr. Gunn? A. I don't know what was in the minds of the people who selected me.

Q. Because of your lack of personal knowledge, is it not fair to say that the statements which you have made

in Exhibit 26 are not based on personal knowledge but are predicated upon conclusions which you reached as a result of your study? A. Yes, sir, that is correct to say. I have no personal knowledge whatever of McCall Ferry's construction nor, indeed, [6581] with any of the events in the history of Holtwood Company prior to 1930.

Q. Were all of the essential facts relating to the early history of Penn Water available to you? A. I don't believe I quite understand that. I don't know just how to answer that. If all of the facts that are included in Exhibit 27 and Exhibit 26 and three or four filing cases full of records in Baltimore which the staff has had access to in the last two years were available to me. If there are any more facts available there then they were not available to me.

Q. Is it not a fact that in the preparation of Exhibit 26 in many instances you had necessarily to draw upon suppositions and conjectures? Isn't that so, Mr. Gunn? A. Yes. The reason you will find those suppositions—and I believe they are all indicated in Exhibit 26—is because of cases where we didn't have proof which looked positive to me. I didn't want to indicate we had proof if we didn't have it.

Q. I believe you have indicated that the report, Exhibit 26, was prepared by others under your general supervision. Is that right? A. That is not quite right. I also worked on the preparation myself as well as supervised that and other phases of the original cost study.

[6582] Q. Except for that modification my statement is correct? A. Yes, sir, that is correct.

Q. Before you set Exhibit 26 up in final form, I believe you have indicated that you had a tentative draft? A. I had a draft which was an evolution. I started off with an explanation of how I came upon the facts in Exhibit 27: A part of the facts in Exhibit 27 I found in the company's records early in my study of original cost. I then prepared a first draft, or the beginning of Exhibit 26 based upon those facts. Many of the facts in Exhibit 27 came from

sources outside of our company—from the records of others and from the exhibits supplied by people who had been connected, the affidavits supplied by people who had been connected with McCall Ferry Power Company. As more and more information came into my hands I continually revised what is now Exhibit 26, until it gradually evolved into the form you now see it.

* * *

By Mr. Hall:

Q. To whom did you submit your tentative draft for [6583] review and comment other than the attorneys you have referred to, Mr. Gunn? A. At various stages of the preparation of Exhibit 26 I submitted it to different people. I believe I submitted it to Mr. O'Connor, I believe also Mr. Higgins——

Q. Of Lee, Higginson & Company? A. No, of Pennsylvania Water and Power Company. I discussed it with Mr. Walls. I don't recall whether I actually submitted him a copy of the draft or not, but I discussed it frequently with him, reports on which I did not have complete information all during the preparation of Exhibit 26.

Q. You submitted this tentative draft to individuals outside of Penn Water's organization, didn't you, Mr. Gunn? A. Well, except the company counsel. Otherwise, no.

Q. Didn't you submit a portion of your tentative draft of Exhibit 26 to Mr. Fisk? A. Yes, a portion of it, but not the whole. I submitted a portion of Exhibit 26 to Fisk, Hutchinson, and Hopkins, I believe, as I recall it. In other words, I submitted a portion of it which was applicable to their phase, to the phase of the history to which they were concerned, to all of those people of whom I asked for statements.

Q. Why were you interested in having others review and comment upon your tentative draft? A. To verify it against their memories as to its [6584] accuracy.

Q. Did the comments cause any revisions to be made? A. Oh, yes. They made it possible for me to put the facts together so that they appeared to make a consistent story. For example, without the information given me by Fisk and Hutchinson it would have been probably impossible for me to put the whole story together, because at that stage there was vital information missing and I couldn't seem to find the complete pattern into which all of the facts I then had could fit.

Q. When you got the information you have just referred to you still didn't have all of the essential information, and for that reason you had to draw upon suppositions and so forth? A. I believe I had all the important information. I had to fill in certain more or less minor points from supposition and conjecture. I think that is correct.

Q. Are those revisions that you have referred to reflected in the present Exhibit 26? A. Yes, sir, the present Exhibit 26 is final.

Q. Would you state specifically what suggested revisions were made by those who reviewed the tentative draft but were not incorporated in Exhibit 26? A. I don't recall there were any, if I understand your question correctly. May I have it again, please?

[6585] (Question read.)

THE WITNESS: I don't recall there were any.

By MR. HALL:

Q. I take it from what you have said that you believed that those who reviewed your tentative draft had historical data which you had not examined prior to the submission of a portion of the tentative draft to them. A. Yes, I thought perhaps they did have. That is the reason I went to them for their assistance.

* * *

[6586] By MR. HALL:

Q. In the first paragraph of your letter of transmittal to Mr. Walls, Penn Water's president, you state that it was

upon the basis of the facts contained in this report, Exhibit 26, that the company's claim for parts of its original cost was predicated. Isn't that so? A. Yes, sir.

Q. Will you detail the parts of Penn Water's claim which are predicated upon the statements contained in Exhibit 26?

* * *

[6587] The Witness: No, I cannot give you the details of them. The only thing I can say that Exhibits 26 and 27 were prepared for the purpose of supporting the company's original cost claim in any and every respect they might serve for that purpose. I can't go through and undertake to pick out each and every item that might be in some way supported by Exhibit 26 and Exhibit 27. I think the whole cost claim is in some way supported by it.

By Mr. Hall:

Q. You certainly wouldn't have any trouble indicating the major items of claim contained in Exhibit 26?

Mr. King: May I inquire, Mr. Hall, what you mean by "major"?

Mr. Hall: Any substantial item.

Mr. King: Dollarwise?

[6588] Mr. Hall: Yes.

The Witness: I would say interest during construction is one item that is supported by Exhibit 26 and Exhibit 27. The acquisition cost of early lands and water power rights is another, the compensation paid to various people who assisted in the early development of the project prior to the formation of the McCall Ferry Power Company. It seems to me those are the major items.

By Mr. Hall:

Q. Wouldn't you also include in the major items the cash value of the stock of the McCall Ferry Power Company and Penn Water, that is so-called cash value? A. Yes, I would include the cash value of that stock given for

services. That is what I had reference to when I mentioned compensation of those who had rendered services, that compensation being largely in the cash value of this stock.

Q. In the second paragraph of your transmittal letter you state that you made a thorough investigation of the early history of Penn Water and its predecessors. Is that right? A. Yes, sir, it is as thorough as Exhibit 26 is.

Q. You also state, do you not, that you believe all of the available sources of information were examined which you thought would reveal early historical facts? [6589] A. Yes, sir.

Q. You further state in the letter of transmittal: "We believe that all of the available sources which could be expected to reveal early historical facts have been carefully examined." Is that correct? A. Yes, sir.

Q. Did any individuals other than those you have named assist you in the preparation of Exhibit 26?

> Mr. Sparks: You mean during the cross-examination, Mr. Hall?
>
> Mr. Hall: This morning.

The Witness: Including everybody in the company and out of the company?

By Mr. Hall:

Q. Yes. A. I don't know. I may have gotten odd bits of information contained in Exhibits 26 and 27 from other people. I think I have named the people who supplied most of it.

Q. For instance? A. Maybe I haven't, either. Some of the information in Exhibit 27 was obtained from Coudert Bros., Hutchinson's lawyers.

Q. During the course of your investigation, did you find any documentary or other evidence in conflict with the statements which you have made in Exhibit 26? [6590] A. No, sir, except to the extent it is contained in Exhibit 26. I make that reservation because of the data that is given in

Exhibit 26 on stock value. If you want to call some of that contradictory, perhaps some of it is.

* * *

[6596] Q. And did you go through the same process in arriving at other conclusions reached in your report? By that I mean the same process you went through in arriving at the date of October 1, 1911, weighing evidence and rejecting evidence? A. What process do you refer to?

Q. Weighing evidence and rejecting evidence in part. A. I am not aware of having weighed any evidence and rejecting it. I didn't consider the annual reports you referred to as evidence of the date of commercial operation.

Q. Do you mean that you didn't find any evidence which was in contravention of the conclusions that you reached in Exhibit 26? A. No, I can't quite answer that question simply. I found a considerable volume of evidence which had to be considered in arriving at the date of October 1, 1911. The [6597] evidence was not all of exactly the same sort. However, it seemed to me an impartial weighing of it all indicated October 1, 1911, was the proper date of commercial operation.

Now, to the extent that all of the evidence I had was not identical it might be said to have been somewhat in contradiction.

Q. What you are saying is that even though you had considerable evidence available to you, you did not discuss or refer to all the evidence in your report, Exhibit 26? A. No, that is not what I am saying.

Q. What are you saying? A. I am saying this—perhaps I am wrong.

Mr. Sparks: Do you want the question again, Mr. Gunn?

The Witness: Yes, I want the question. I had better have it read.

(Question read.)

The Witness: The answer to that is "Yes." I obviously couldn't put all the evidence in that small report.

By Mr. Hall:

Q. In other words, you weighed the evidence in your mind without discussing it in your report? A. Yes, we have a very great volume of evidence in the company's records which couldn't possibly be incorporated in Exhibit 26. For example, we have the operating log sheets of the power plants. We have a vast volume of operating records, [6598] all of which have a very vital bearing on the determination of the date of commercial operation and couldn't possibly be incorporated in Exhibit 26. All of the evidence, however, has been available to the Commission staff for the last two years.

Q. Mr. Gunn, generally what documentary and other evidence did you examine in connection with the preparation of your report? I am talking now only about the evidence in the files of Penn Water.

Mr. King: By "report" you mean Exhibit 26?

Mr. Hall: Yes, I mean Exhibit 26.

* * *

The Witness: I examined all of the evidence I could find in the files. That included operating records, construction diaries kept by McCall Ferry Power Company, the books of accounts, the documents and facts relating to the bankruptcy in McCall Ferry Power Company, those relating to the reorganization of the company, and the early log sheets, operating log sheets, of the company, as well as all of the general correspondence files.

By Mr. Hall:

Q. Did you examine any documentary evidence not in Penn Water's possession? A. Yes.

[6599] Would you specify the other documentary evidence? A. I examined documentary evidence which was obtained from the files of Coudert Bros., that was obtained from the

files of Lee, Higginson, and I believe I also obtained some from the files of Simpson, Thacher & Bartlett.

Q. Would you identify the law firm last mentioned? A. They were the counsel who were brought into the McCall Ferry Project when Fisk's firm took control of the project. They were Fisk's lawyers that he generally used in connection with his promotion, as I understand it.

Q. What documentary evidence are you relying on when you say the Fisk Company took control of the McCall Ferry project? A. On Hutchinson's statement that they took control and also Fisk's statement that they took control, and I believe the general impression that I obtained from Mr. George C. Lee, of Lee, Higginson, that they took control.

Q. Did you examine the files of Bertron, Storrs & Griscom? A. I obtained information from their files. It is included as an item in Exhibit 27. It is information relating to the price at which they carried the securities of McCall Ferry Power Company. I think it is Part 23.

* * *

[6600] Q. Doesn't Mr. Adams state in his letter of May 27, 1938, that "We are not able to be of great assistance to you in this matter, as several months ago we had all of our correspondence files prior to 1914 destroyed to reduce storage space."? A. Yes, it does state that.

Q. What files did they have, then? A. They had some stock ledger, I believe, in which they had recorded the value of these securities.

Q. They didn't have any correspondence file, did they? A. No.

Q. The Mr. Adams I referred to is Secretary and Treasurer of Bertron, Griscom & Company. Is that right? A. That is right.

Q. Is that firm a successor to Bertron, Storrs & Griscom? A. Yes, sir.

Q. Did you attempt to secure any information from Mr. H. F. Dimock? A. I attempted to locate any papers

that were left by his estate. As I recall it, I believe Mr. Dimock was dead at the time I was making the original cost study.

Q. Did you locate any papers? A. No, I did not. I understood any records relating [6601] to McCall Ferry Power Company long-since had been destroyed.

Q. Did you attempt to secure any information from W. B. Parsons? A. No, I don't recall I did. I didn't expect Parsons would have any information particularly pertinent that I couldn't get otherwise. For example, Parsons would have been an outright duplication of Hutchinson.

Q. At least you thought that. A. Yes.

Q. But you didn't know that to be a fact? A. He was a consulting engineer and so was Hutchinson. I would expect they would both have the same information available to them, except Hutchinson would have more.

Q. Parsons prepared a more extensive report relating to the proposed Holtwood development? A. Yes, sir, and I had his report.

Q. That report is incorporated as Part 3 of Exhibit 27? A. Yes, sir.

Q. Is Mr. Parsons still alive? A. I believe he is dead.

Q. Was he alive when you were making your original cost study? A. I really don't know. In any event I made no attempt to contact him.

Q. Did you attempt to secure any information from Mr. [6602] C. A. Coffin? A. I believe I did. As I recall it, Mr. Coffin was dead.

Q. You say he was dead? A. As I recall it he was, yes.

Q. Who did you contact to get permission to examine his files? A. I think I inquired of General Electric Company if they still had his files.

Q. What was Mr. Coffin's connection with General Electric? A. I believe he was president.

Q. During the construction of the Holtwood project? A. During construction of the Holtwood project, yes.

Q. Did General Electric have any files relating to the construction and early history of the Holtwood project? A. No, not that I recall.

Q. So the files of General Electric were of no assistance to you? A. No, that is right.

* * *

[6603] Q. Are you an accountant, Mr. Gunn? A. No, sir.

Q. Have you ever studied accounting? A. No, sir.

Q. What if any accounting experience have you had? A. I don't think I have ever had any experience as an accountant. I have had some experience on the segregation of expenditures between operating expenses and capital. If you call that accounting I have had that much accounting experience. I never have laid any claim to that distinction, to the distinction of being an accountant.

Q. This experience you have referred to is in connection with single entry accounting or double entry accounting? A. I don't know. It didn't seem to me to make any difference.

Q. You are an engineer by profession, however? A. Yes, sir, I try to be.

Q. So that in preparing your studies on original cost you brought to it your engineering knowledge, is that right, and not accounting training and experience? A. Yes, I think that is correct, except that I had the assistance of several capable accountants in the preparation of this, as I have already explained.

[6604] Q. Do you mean the four individuals that you previously referred to—Eichhorn, O'Connor, Rich, and Stupp? A. Yes, I referred to those. I believe I should make a correction there. In referring to Rich, I think the man's name I had in mind was Frisch instead of Rich.

Q. F-r-i-s-c-h? A. Yes.

* * *

By Mr. Hall:

Q. What accounting problems did Mr. Eichhorn assist you with? A. As a matter of fact, the biggest accounting problem I believe was the preparation of the accounting control statement which was used in the reconciliation of the book cost with the physical inventory of the property.

Q. That assistance rendered by Mr. Eichhorn involved no accounting conclusions included in your results. Is that so? [6605] A. May I have that question, please?

(Question read.)

The Witness: I wouldn't say that is correct at all. It seems to me it did. Certainly he had to come to some accounting conclusions to prepare these control statements.

By Mr. Hall:

Q. What conclusions do you refer to now? A. Conclusions necessary to prepare the statements.

Q. What are they? A. Whatever conclusions an accountant must arrive at in order to prepare such a statement.

Q. Can you state what Mr. Eichhorn did involved reaching accounting conclusions? A. As I understand an accounting conclusion it did.

• • •

[6606] Q. Did Mr. Eichhorn make any accounting contributions to acquisition cost during the early period? A. I don't believe I understand what you mean by "acquisition costs during the early period." To what do you refer to?

Q. Lands, rights of way, and water power rights. A. He made a contribution to the extent he assisted me in the preparation of Exhibit 26, and that deals with acquisition costs.

[6607] Q. What assistance did Mr. Eichhorn give you on the cash value of the securities?

Mr. King: What securities, Mr. Hall?

Mr. Hall: Of McCall Ferry Power Company and Penn Water.

The Witness: His assistance on that problem was limited to his participation in assisting me in the preparation of Exhibit 26 and Exhibit 27.

By Mr. Hall:

Q. What parts of those exhibits? A. The whole of those exhibits.

Q. With respect to what accounting principles did you consult Mr. Eichhorn? A. I don't have any recollection of any particular consultation. Any time I needed accounting advice I went generally to Mr. Eichhorn. On some problems I perhaps also consulted Mr. O'Connor.

Q. Do you recall any specific instances in which you consulted with him? A. No, I don't know.

Q. What accounting contributions did the other accounting individuals make to your original cost study? A. Their contribution was primarily the analysis of the company's books to derive the details of the costs as recorded there. Those other accountants worked under the supervision of Mr. D. L. Wetzel.

[6608] Q. Those were figures and not conclusions, is that right? A. Yes.

Q. Is Mr. Wetzel an accountant? A. No, sir. He has had considerable cost-keeping experience.

Q. Did he render any assistance to you? A. Oh, yes, a very considerable amount.

Q. Of an accounting nature? A. I don't believe I understand what you mean by rendering assistance of an accounting nature.

Q. Did he arrive at any accounting conclusions which assisted you in your determinations? A. That doesn't help me very much. I can tell you what he did. I don't know whether that would be——

Q. I think that would clarify it. What did he do? A. He had working under his supervision a group of people

that I believe run as high as 18 or 20 whose duty it was to first make a physical inventory, and then make an analysis of the company's cost records, and then reconcile the analysis of the cost records with the inventory of the company's property.

If that involved accounting conclusions or assistance, then he rendered it. If it didn't, he didn't.

Q. You are familiar with Electric Plant Accounts Instruction [6609] 3-D, are you? Will you refer to Page 39 of the instructions to Electric Plant accounts? A. Yes, sir, I am familiar with that.

Q. Did any accountant determine the meaning of this construction of Section 3-D? A. I wouldn't say they finally determined it.

Q. Who finally determined it? A. I would say it was a joint determination between myself and the accountants and the company's counsel.

Q. How did the accountants interpret Instruction 3-D? A. The same way that the company has treated it.

Q. You mean they were all in agreement? A. Yes, I think we were all in agreement.

Q. What was the conclusion reached by all of you as to that instruction? A. When the consideration for property is other than cash the value of such consideration shall be determined on a cash basis.

Q. What did you determine: the value of the property or the value of the securities? A. We were uncertain on that as to which one we should determine. I thought perhaps maybe we ought to determine both.

Q. What does Instruction 3-D require? A. There is also uncertainty about that.

Q. Then there was not any unanimity of opinion there? [6610] A. It was a unanimity of lack of it, then. Let us put it that way.

Q. How did you finally conclude Instruction 3-D had to be construed? A. That it had to be construed we had to estimate the value of the securities which were given in

exchange for services, and in doing that it was necessary in some cases to estimate the value of the services as a measure of the value of the securities.

[6611] Q. Do you interpret instruction 3-D to mean that you are to determine the cash value of the securities by determining the value of the property or service?

THE WITNESS: May I have that question, please?

(Question read.)

By MR. HALL:

Q. That is services which are rendered? A. No, I wouldn't necessarily interpret it that way. However, in the case of McCall Ferry Power Company, where the securities were never traded on the market, there obviously was no other way to value the securities except on the basis of the things for which they were exchanged.

* * *

Q. What you did then, Mr. Gunn, was to determine the [6612] value of the services rendered and attribute that value to the securities. In other words, the value of the services were deemed to be the cash value of the stock issued for the services? A. Generally speaking I think that is true. Of course there were other elements which entered into it but generally speaking I think that is a true statement.

Q. You assumed there was an equivalence between the two. Is that right? A. Yes, where it was based directly on that basis. For instance, in the case of Lee, Higginson service I assumed there was an equivalence between the services and the value of the stock given at the time it was exchanged.

* * *

[6615] Q. Where is the cash value of the securities of the McCall Ferry Power Company and Pennsylvania Water and Power Company which you claim, recorded on the books?

The Witness: May I have the question, please?

(Question read).

The Witness: I don't think I made any such claim as that, but an amount sufficient to cover the value of the securities of McCall Ferry Power Company is most certainly included in the opening entry of Pennsylvania Water and Power Company.

* * *

[6620] Q. To whom do you have reference when you say "Hutchinson interests"? A. To Hutchinson and his father-in-law, Mr. Dimock.

* * *

Q. Were those the only individuals included in the group which you referred to as the Hutchinson interests? A. So far as I know. That was a term we used to [6621] designate Hutchinson himself, and Dimock, both of whom we knew were a part of the group, and also, if you will notice, Hutchinson in his statement which he gave us in connection with the development of the history of the McCall Ferry was not very definite as to who had rendered him financial assistance and for that reason I couldn't be more definite.

If you wanted to broaden the term I think you could say that Beyer and Willson, and at one time I think Bogart, was associated with Hutchinson.

Q. How about W. B. Parsons? A. I believe I was mistaken in mentioning Bogart. I believe I had in mind Mr. George S. Morison who was a consulting engineer. I understand he was at one time associated with Hutchinson in the development of the river. Before the organization of McCall Ferry Company, Morison had died and I believe Hutchinson had bought his interest.

Q. Would you include C. A. Coffin as a member of the Hutchinson group? A. No, I didn't have in mind Coffin as a member.